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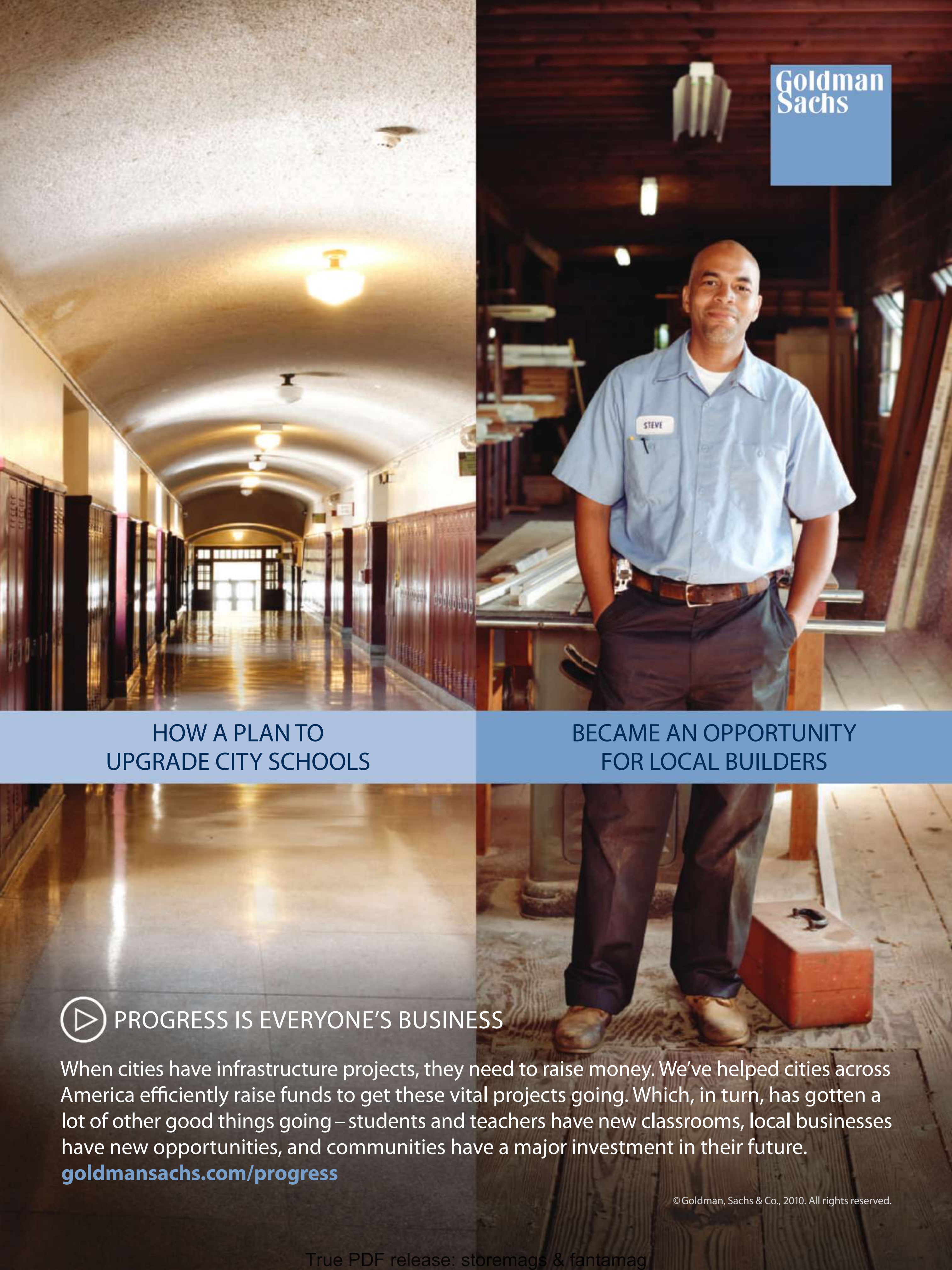
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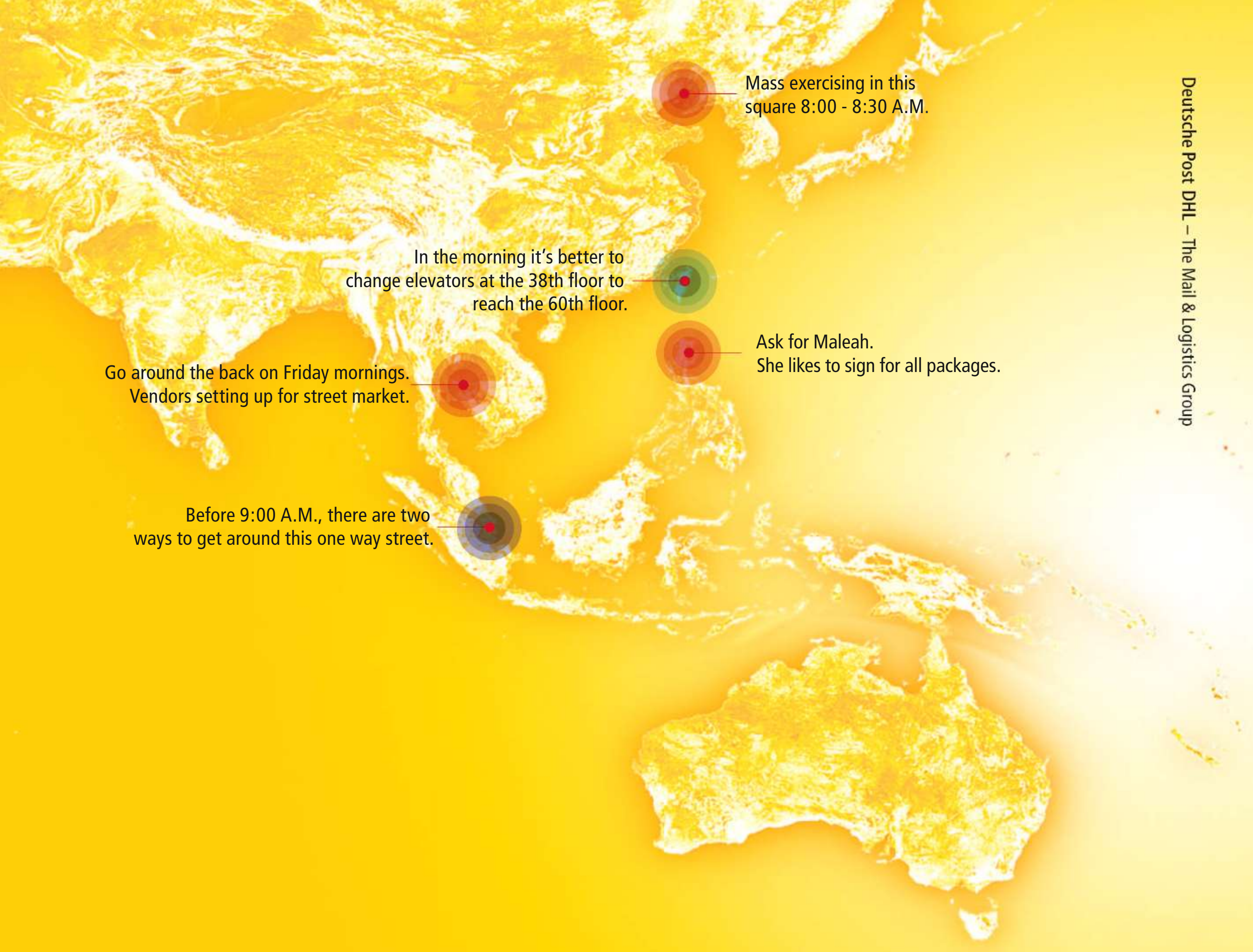
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Feedback

The Greeks beg to differ



▶ Regarding "For Sale-ish" (Features, Oct. 11) by A. Craig Copetas: First, this piece presents a total lack of distinction between public and private islands. The two should not be confused. Greek public islands are not up for sale.

Second, the piece makes numerous references to the current Prime Minister's "enthusiasm" and his support for the sale of Greece's public islands. Quite to the contrary, the current Greek government has remained adamant that Greece's islands will not be put up for sale and that the development of these islands, particularly for high-value tourism and renewable energy, could generate substantial economic growth. This position is well documented in countless interviews, speeches, and statements.

This article's incorrect view of Greece and the Greek development agenda is surely a result of the author's official sources, who are almost exclusively representatives of the previous conservative administration. The only current government spokesman the reporter contacted, it turns out was [Piraeus Real Estate Chief Executive Officer George Papaioannou,] the aforementioned bank employee.

Had the reporter contacted this office to check his facts on the Prime Minister's policy, much of this confusion and misinformation could have been avoided. As a matter of fact, this administration has adopted legislation that addresses the problems of the past to which he refers.

Indeed, Greece has its challenges to overcome. Yet one wonders why–other than pure sensationalism–Mr. Copetas would go to such lengths to distort the reality of this country.

If this article is indeed "the best wacky story on Greece yet," as your cover regretfully states, it can only be the result of sloppy reporting and a staggering lack of fact-checking.

Vassilis Papadimitriou
International Press Desk
Office of the Prime Minister of Greece

Editor's Note: We are glad to provide an opposing viewpoint. Our reporter made several documented attempts to provide the Greek government an opportunity to explain or add to the story. Bloomberg Businessweek *stands by the story.*

Tea and antipathy



▶ Regarding "The Devil You Don't Know" (Features, Oct. 18): I am in the Tea Party movement. The interest on our debt this year approaches $400 billion. The Office of Management and Budget has said that interest on the debt will be more than $700 billion in five years. But in your Oct. 18 issue I see a sinister picture of Sarah Palin.

News flash: Sarah Palin is not the problem. The Tea Party is not the problem. Federal government spending is extreme, out of control, and the Democrats in particular have no plan to fix the problem. And I don't need you telling me who business does or does not trust.

Martin Harper
San Antonio

▶ Your Oct. 18 issue, the one with the worst picture of Palin you could possibly find, does yeoman duty for the Democratic National Committee with a timely report emphasizing every "extreme" Tea Party associate's utterance available. Is the business world really satisfied with the direction the Administration and Congress has attempted to take the country? It would seem not, given the lethargic state of the economy. How about an analysis of how the Democrats in Congress contributed to the housing crisis with their homes-for-everyone initiatives? Remember their "if it ain't broke, don't fix it" response when warned by the Bush Administration that Fannie Mae and Freddie Mac were in a heap of trouble?

I had hoped that *Bloomberg Businessweek* would deliver a bias-free view of the financial world and not try to influence elections.

Thomas Freitas
Honolulu

▶ In reading "The Devil You Don't Know" and viewing the unflattering cover picture of Sarah Palin, I kept wondering where the two authors came from–*Newsweek*, *Vanity Fair*, *The New Yorker*?

In spite of the expected New York groupthink bias with its emphasis on extreme right-wing views, the piece did provide some useful information.

Norman L. Scott
Fort Lauderdale

▶ Have you lost your minds? Do you really think this woman, Sarah Palin, is influential? She doesn't have anything intelligent to say. She's good at pandering to her base and bashing the President. She is someone who has no problems stirring up the militia, the KKK, and any other crazy who wants to take out our representatives and the President himself. It makes a lot of money for her.

You need to put the President on the cover and talk more about his accomplishments. Small wonder we don't have more decent people running for office.

Shirley Slaughter
Oak Park, Mich.

Corrections & Clarifications

B "A Reformist Leader Who Cannot Reform" (Global Economics, Oct. 11) incorrectly identified economist Robert Prior-Wandesforde's place of work. He formerly worked with HSBC. In August he became head of South East Asia and India Economics at Credit Suisse in Singapore.

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Opening Remarks



The Inequality Delusion

Americans think the U.S. has far more income equality than it has. They want it to be even fairer. Yet they hate the policies that would make it so. By Drake Bennett

"I think when you spread the wealth around, it's good for everybody." So said Barack Obama almost exactly two years ago to an opinionated plumbing company employee named Joe Wurzelbacher. The comment, captured on video, was one that then-candidate Obama would have reason to regret: Joe the Plumber's celebrity has waned, and a defeated John McCain has gone back to the Senate, but the quote has lived on among the President's critics as evidence of his unabashed liberalism–even, to many, his secret socialism. "That is what change means for Barack the Redistributor: It means taking your money and giving it to someone else," McCain said at the time. "He believes in redistributing wealth, not in policies that grow our economy and create jobs."

Political equality is a sacred idea to Americans; economic equality, however, is not. Spreading the wealth is what Marx wanted to do, and Mao. One rallying cry of the Tea Party has been that health-care reform, the stimulus, and the proposed climate change legislation all amount to stealthy ways to redistribute billions of dollars downward. The impending elections are expected to sweep into Congress a crop of Republicans vehemently opposed to the leveling effects of activist liberal government.

Minnesota Representative Michele Bachmann, founder of the Tea Party Caucus, attacked the BP oil spill victims fund as "a redistribution of wealth," and Pat Toomey, the Tea Party-backed U.S. Senate front-runner in Pennsylvania, decries all governments for "confiscating the wealth they choose to transfer." Even Robin Hood, as portrayed by Russell Crowe in last spring's film, wasn't robbing from the rich to give to the poor but fending off the predations of greedy tax collectors.

So it might be surprising to learn that Americans are in broad agreement on the need for a more equal distribution of wealth. Yet that's what a forthcoming study by two psychologists, Dan Ariely of Duke University and Michael I. Norton of Harvard Business School, has concluded. First, Ariely and Norton asked thousands of Americans what they thought the nation's actual wealth distribution looks

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A visualization of the data from eMeter's readings for an average home for one year.

1. Based on published benchmark results. Results as of 9/13/10. Sources: IBM press release http://www-03.ibm.com/press/us/en/pressrelease/29315.wss and eMeter press release http://www.emeter.com/2009/emeter-demonstrates-industry%E2%80%99s-most-scalable-smart-grid-management-capability/. IBM, the IBM logo, ibm.com, Power Systems, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. Other product and service names might be trademarks of IBM or other companies. A current list of IBM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2010.

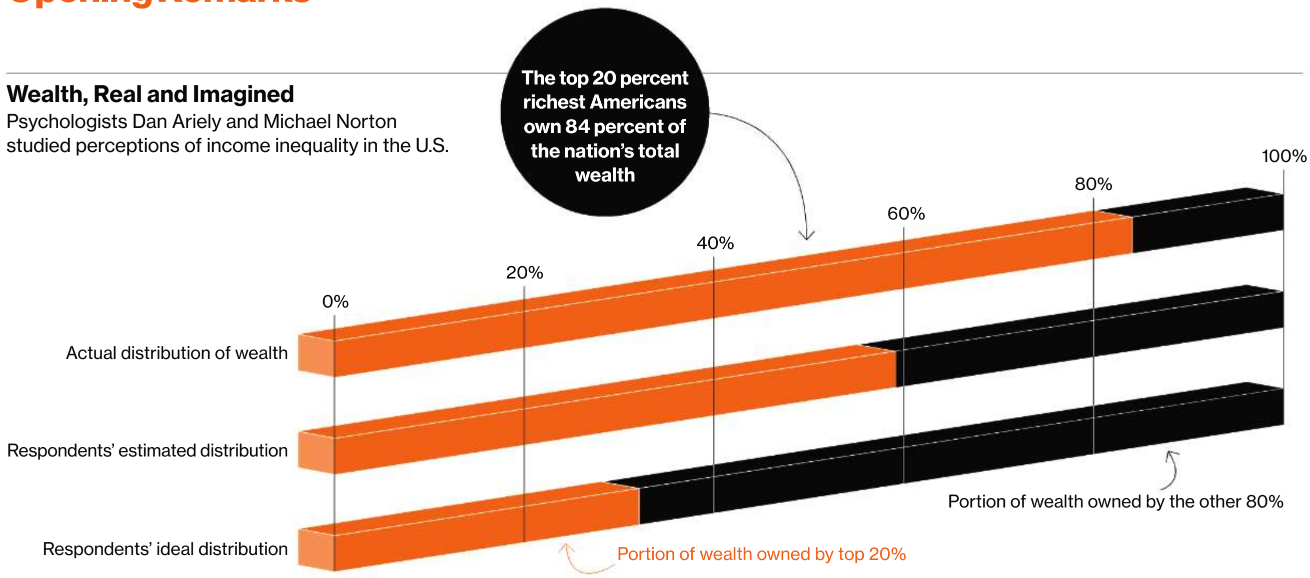
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Opening Remarks

Wealth, Real and Imagined

Psychologists Dan Ariely and Michael Norton studied perceptions of income inequality in the U.S.



DATA: MICHAEL I. NORTON, DAN ARIELY

like: how much is owned by the wealthiest 20 percent of the population, the next-wealthiest 20 percent, and on down. The researchers then asked people what, in an ideal world, they would like the nation's wealth distribution to be.

Ariely and Norton found that Americans think they live in a far more equal country than they in fact do. On average, those surveyed estimated that the wealthiest 20 percent of Americans own 59 percent of the nation's wealth; in reality the top quintile owns around 84 percent. The respondents further estimated that the poorest 20 percent own 3.7 percent, when in reality they own 0.1 percent.

And when asked to give their ideal distribution, they described, on average, a nation where the wealth distribution looks not like the U.S. but like Sweden, only more so—the wealthiest quintile would control just 32 percent of the wealth, the poorest just over 10 percent. "People dramatically underestimated the extent of wealth inequality in the U.S.," says Ariely. "And they wanted it to be even more equal."

The United States, according to this study, is a nation of people who would like to spread the wealth around. They just don't know it.

Can it really be that simple? In part, this work fits into a proud tradition of social science research demonstrating the basic ignorance of the average American. (Ariely and Norton conducted a small follow-up survey of economists and found that though their estimates were better than average, they also got it wrong.)

It's possible that if more people understood how deeply unequal American society has become they would support measures to combat it. The U.S. now has the world's second-lowest level of income mobility between generations, after England, according to research by economist Miles Corak at the University of Ottawa. Yet studies have also shown that voters have an impressive ability to absorb information that contradicts their beliefs without letting it change their minds. People support the abstract goal of equality, it seems, while staunchly opposing specific government measures—whether increasing tax rates or limiting executive pay—designed to impose it. Getting there, in other words, is what starts the political arguments, even at a moment of widespread bipartisan anger at Wall Street.

The government's primary tool for reducing wealth and income inequality is taxation. In the 1950s and 1960s, when the U.S. was a far more financially level country, the pretax salary differential was much smaller than today. The wealthiest earners also paid far more in taxes: During the Eisenhower years the top marginal rate was over 90 percent for income over $400,000. Any attempt to reimpose that sort of tax rate today would lead to a flight of wealth and talent from the U.S. And with apologies to the social scientists, other ideas for dramatically reducing the income gap are in short supply.

The U.S. is a nation of people who would like to spread the wealth around. They just don't know it.

What's more, most economists would agree that the degree of wealth equality that the study's respondents identified as ideal would be disastrous, because it would seriously retard growth—sapping incentives to work and innovate, perhaps even requiring coercive measures mandating that the poor save rather than spend their money on necessary consumption.

"It's probably a good thing that the public underestimates how much wealth inequality there is," says Bryan D. Caplan of George Mason University, since "they tend not to understand the ways that wealth inequality is good."

Ariely and Norton are now working on a new set of surveys designed to refine their findings. Their goal is to try to discern what Americans think about basic questions of justice when hot-button details like the estate tax or the minimum wage are stripped away.

"We're asking, on a broad level, 'What kind of country would you like to live in,' and from there we try to boil down to specific policies," says Norton.

With the nation on the cusp of one of the angrier elections in recent memory, perhaps it's enough to focus on Ariely and Norton's most basic finding. In an era of political vitriol, their results show a remarkable degree of consensus. Rich and poor, Republican and Democrat—all those surveyed shared a similar vision of what they thought America looked like and what a fairer society would be. It's not much, but it suggests that, at least in our egalitarianism and our ignorance, we are all alike. B

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14%

Gain in U.S. farm exports in first eight months of 2010, according to the USDA

Those Amber Waves Are Fueling Exports

▶ **Foreign demand for U.S. grain keeps rising, and farmers have cash to spare**

▶ **"It is a perfect situation for U.S. farmers, the best since the early 1970s"**

Just a few years ago, who would have guessed that farms would turn out to be a bright spot in the U.S. economy? Farmers were fretting about falling prices and mounting competition from Russia and Ukraine. Today drought has withered much of the Russian and Ukrainian crops, and the world needs more grain—and soybeans and pork—than ever. The best place to get it: the fertile soil of the U.S. Midwest and South, home to some of the most productive farms on earth.

In the first eight months of 2010, U.S. agricultural exports increased 14 percent, to $69.8 billion, from the same period a year earlier, according to the most recent U.S. Agriculture Dept. data. Joseph Glauber, chief economist for the USDA, says farm exports in the year that began on Oct. 1 may top the 2008 record.

This cornucopia is providing an unexpected boost to President Barack Obama's drive to double exports by 2015. China's need for cotton, pork, corn, and soybeans will make it the second-biggest U.S. agricultural trading partner in 2011, the USDA estimates. Shipments of farm products to China will total $15 billion, compared with Canada's $16.8 billion and Mexico's $14.6 billion. Corn prices are up over 60 percent since June, while wheat as much as doubled. "It's going to be the best year American farmers have had in two and a half decades," says Dennis Gartman, an economist and editor of *The Gartman Letter* in Suffolk, Va.

"I've seen more brand-new combines bought than I've seen for a long, long time," says one lender to farmers

The cash that farmers are fingering in their pockets is boosting companies at home as well. While agriculture accounts for just 1 percent of the $14.3 trillion U.S. economy, the actual impact of surging prices may be 10 times more once spending on equipment, seeds, grain handling, and food processing is added, says Jason Henderson, an economist at the Federal Reserve Bank of Kansas City.

Sales of farm equipment are correlated to growers' cash receipts,

DANIEL ACKER/BLOOMBERG

which should increase 24 percent, to $118.4 billion, for major crops in the 2010-11 season, Ann Duignan, an analyst at JPMorgan Chase in New York, said in an Oct. 8 report. That's good news for Moline (Ill.)-based **Deere**, the world's largest farm-equipment maker as well as rivals Amsterdam-based **CNH Global** and Duluth (Ga.)-based **Agco**, she says.

Deere's per-share profit will more than double, to $4.25, in the current fiscal year, according to the mean estimate of eight analysts surveyed by Bloomberg. **Cargill**, the giant grain handler and food processor, said on Oct. 12 that thanks to price volatility and the performance of its affiliate, fertilizer producer **Mosaic**, profit for the latest quarter rose 68 percent.

Back in the 1980s, falling prices, record-high interest rates, and too much farmland bought on credit prompted a wave of farm bankruptcies. Now low interest rates are amplifying the boom, says Tom Neher, vice-president for AgStar Financial in Rochester, Minn. The bank issued twice as many farm-equipment loans as expected in a recent promotion. "I've seen more brand-new combines bought than I've seen for a long, long time," says Neher, who helps manage $2.1 billion in grain-related loans and leases for AgStar. "When you can get a machinery loan for 4 percent interest, that's about as low as it ever gets."

There are limits to how much cash will trickle down to the Main Streets of rural America, says Ernie Goss, an economics professor at Creighton University in Omaha: "You have fewer and fewer farms, and fewer and fewer farm families, so it hasn't spilled into small businesses like the drugstore or the shoe store." Farm prices have been supported by a lower dollar, which boosts exports, and not by rising domestic demand, says Goss. Small businesses "are mystified by all these reports about how wonderful the rural economy is. That's because they're selling in Greeley, Neb., and the farmer out there is selling in Beijing."

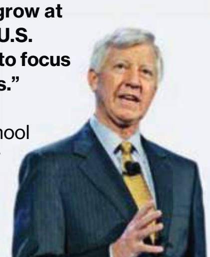
Still, the mix of foreign demand and a weak dollar is the best news farm country has had for decades. "It is a perfect situation for U.S. farmers, the best since the early 1970s," says Bill Adams, a trader at ACT Currency Partner, a currency and commodity specialist in Zurich. "There will be quite a few Cadillacs sold in the Midwest this Christmas."

—Whitney McFerron, Jeff Wilson, Shruti Date Singh, and Elizabeth Campbell

The bottom line *Farm exports from the U.S. are rising fast. That's benefiting farm-equipment makers, fertilizer companies, and other suppliers.*

Quoted

"What's the new normal for CEOs? You don't need to hire, because if we're only going to grow at 1 to 2 percent in the U.S. anyway, we're going to focus on productivity gains."
—William George, Harvard Business School professor and former CEO of Medtronic



Currencies

In Pyongyang, the Dollar Commands Respect

▶ **Heineken and Scotch for the elite, bean paste for the rest**

▶ **"We don't operate like a capitalist country"**



The two sides of Chang Gwang Street in North Korea's capital of Pyongyang show the gap between the Stalinist country's elites and its capitalist-minded citizens. On one side, English-speaking officials mingle with Dutch traders at the Koryo Hotel. There, those with foreign currency can buy Heinekens for about a buck a can at the official exchange rate of 100 North Korean won to the U.S. dollar.

Across the street, a saleswoman at one of the private markets still allowed by the authorities giggles when a foreign guest says he doesn't have the 200 won needed to buy a steamed vegetable bun. She flips the placard to reveal the cost in dollars, the currency of a country that doesn't have diplomatic ties with North Korea. The price: 20¢, implying an unofficial exchange rate of 1,000 won to the dollar.

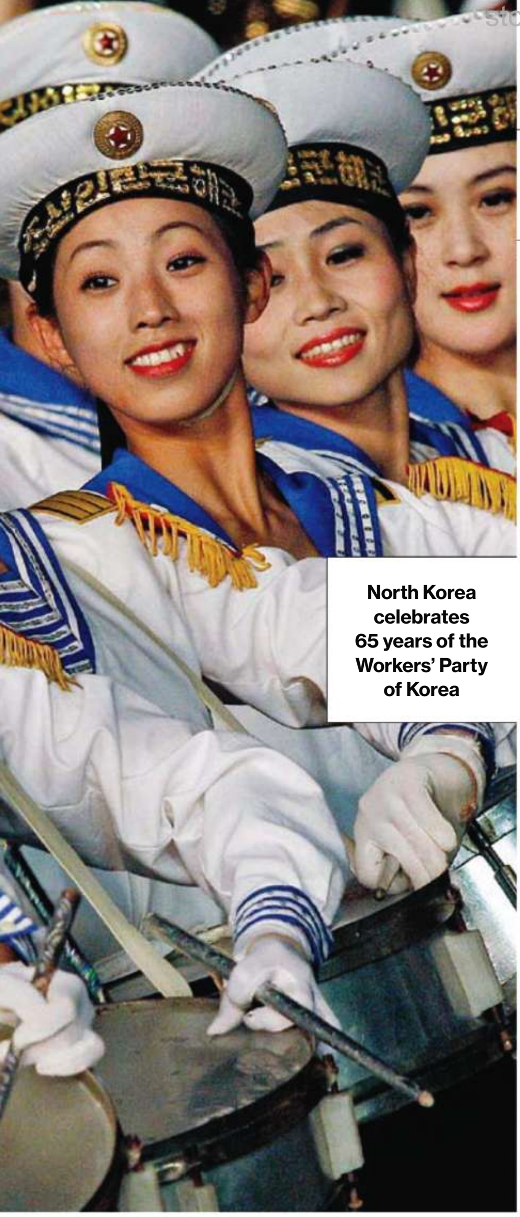
Old Asia hands say this is one of the biggest spreads between the official and unofficial currency rate they have ever seen in the region. Back in the 1980s the gap between the official and market rates in China was not nearly as great as in North Korea today, says Ken DeWoskin, a director of Deloitte's China Research and Insight Center in Beijing, who began his career watching China in the mid-1960s and first traveled there in 1977. "Even closed economies like Cambodia in the 1960s had only a 2-to-1 pricing discrepancy," he says.

President Kim Jong Il moved late last year to revalue the won and limit the amount of cash that North Koreans could exchange for newly printed bills. The policy was designed to clip the wings of the private merchants who were increasingly creating an economy beyond the control of the authorities, according to the University of Vienna's Rüdiger Frank, a political scientist who specializes in North Korea. The impact of the abrupt policy shift extended far beyond the merchants. "The revalua-

FROM LEFT: CRAIG RUTTLE/BLOOMBERG; VINCENT YU/AP PHOTO; ANDREW HARRER/BLOOMBERG

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North Korea celebrates 65 years of the Workers' Party of Korea

tion not only wiped out people's savings, but their trust in the government and their currency," says Ha Tae Keung, founder of Open Radio for North Korea. "There's a widespread belief among North Koreans that their money is going to get further devalued and they'll get poorer just by holding onto it."

The currency turmoil came amid mounting speculation that Kim Jong Il's health was failing. Last month he promoted his son, Kim Jong Un, to four-star general, setting the stage for the country's second hereditary power transfer. The government extended an unprecedented invitation to international media to witness the Oct. 10 anniversary celebrations marking the 65th anniversary of the Workers' Party of Korea.

The next day, Pyongyang residents queued up as usual to spend their won at the Chang Gwang Street market. Twenty-four shoppers patiently lined up to buy a small cone of vanilla ice cream at 20 won each. A similar number waited for shaved ice with sweet bean paste at 5 won a bowl. Fifteen were there to buy sweet potatoes at 60 won per kilo. No one was seen lining up to purchase sausages, which at 1,700 won each were priced at the equivalent of 16 cans of Heineken beer at the Koryo Hotel.

While price tags at the hotel are in won, the national currency isn't accepted there. That wasn't a concern for guests and shoppers buying foreign goods–Scotch whisky and Syrian olive oil were on offer–with dollars, euros, and Chinese yuan.

One hotel worker, who said he made about 2,500 won a month, said the government provided people with food and other necessities such as clothing and housing. The free markets like the one across the street were there to supplement their diets, he said, adding: "We don't operate like a capitalist country."
—Michael Forsythe, with Bomi Lim, Frances Yoon, and Zeb Eckert

The bottom line *North Koreans have lost faith in their currency, as shown by the 10-to-1 gap between the official exchange rate and the unofficial one.*

Workforce

Immigrants in the West Aren't Going Away

▶ Despite a surge of nationalist feeling, most have stayed put

▶ "There are always certain jobs the locals won't do"

Since arriving in France from Mali six years ago, Youba Soumbounou has sorted trash at factories and warehouses near Paris. He got his job by using fake papers and has been told five times by police to leave the country.

His employer, which he asked not be identified, didn't fire him. Instead, it has joined other French waste-treatment companies such as **Veolia Environnement** and **Derichebourg** in seeking legal residency for laborers they need. "If we didn't have access to foreign workers, we simply wouldn't be able to do our work," says Pascal Decary, head of human resources at Paris-based Veolia Propreté. The company found out last year that 18 of its

➜

Tom Keene's EconoChat

Tom talks with author **P.J. O'Rourke** about politics and the economy

P.J., you just came out with a new book, *Don't Vote–It Just Encourages the Bastards*. What is the thing that upsets you the most about our politics right now?
Scope, size. I mean, politics is just one little part of life, and we're letting it creep in everywhere. If you use politics to settle every problem, what you get is Bosnia.

How did you move across the spectrum from left to right?
I was a rabid socialist and I got a job. I get my paycheck for $300 every two weeks and it was in New York City and I netted out at like $180 after taxes and benefits. I said, "Wait a minute." I'm a firm advocate of socialism and I get a job with a capitalist pig corporation only to discover that we have socialism already.

What's your message to Washington?
Butt out and scale down.

If the President read your book, what would you like to see as a change in his day-to-day rhetoric?
We talk in the business world about the smartest people in the room, and, of course, we know what they did to us in 2008. And he acts very much like the smartest person in the room when he's up at the podium.

What's your take on the Tea Party?
It has its flakes like any populist movement. But fundamentally the Tea Party is saying, we just have greater government interference than is healthy in a free society. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

Global Economics

workers have phony documents, Decary says. "There was never any question of us abandoning people who have worked hard for us all these years, doing jobs that natives don't want to do."

France is banning Muslim head coverings. Anti-immigrant parties in Sweden and the Netherlands have made significant inroads. U.S. President Barack Obama has deferred an overhaul of immigration laws because of opposition in Congress and in states such as Arizona. Yet most industrialized nations have done little to oust immigrants. "If you look beyond the noise, you don't hear anyone saying there shouldn't be any immigration at all," says Jean-Pierre Garson, head of the Organization for Economic Cooperation and Development's international migration unit in Paris. "They can't. Parts of the economy would grind to a halt."

A 2008 report by the British Parliament says 17 percent of the U.K.'s economic growth in 2004 and 2005 was the result of immigration. The Washington-based Center for American Progress, run by John Podesta, who was chief of staff to former President Bill Clinton, said in January that making it easier for undocumented workers to gain residency and attracting guest laborers would add $1.5 trillion to the U.S. economy over the next 10 years.

Whether to do undesirable jobs or pay into weakened pension funds, workers from poor nations are needed by the West, says the OECD's Garson. "Decisions are often made on the basis of the emotions of the day," says Ben Noteboom, chief executive officer of **Randstad Holding**, the world's second-largest staffing company. "Yet that emotion will fade away because in the end, when we are in a hospital, we need nurses."

In the U.S., **News Corp.** Chairman Rupert Murdoch, along with chief executive officers from companies including **Delta Air Lines**, **Xerox**, **Marriott International,** and **Yahoo!** are lobbying to ease the way to citizenship for many illegal immigrants. In September, Murdoch urged a House Judiciary subcommittee to bring "an end to the arbitrary immigration and visa quotas."



Ban minarets: Anti-immigrant poster put up by a local German right-wing party

WOLFGANG RATTAY/REUTERS/CORBIS

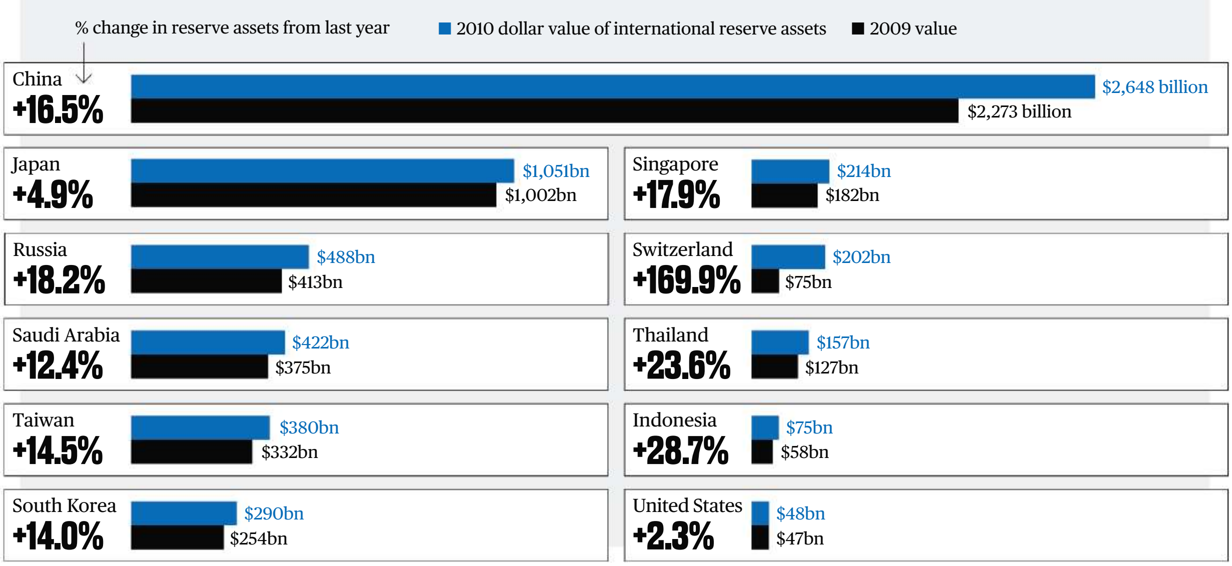
Companies that support immigration can face a hostile public. The minority Dutch government that depends on support from the anti-immigrant Freedom Party plans to ban full-face Islamic veils. Polls show as many as 70 percent of Germans at least partly support former Deutsche Bundesbank board member Thilo Sarrazin, who wrote in a recently published book that Turks and Arabs are making Germany "dumber."

No matter how fearful voters in the West are, the logic of num-

Trade

The Global Surge in Reserves

China's foreign reserves are now worth $2.6 trillion. Brazil, Mexico, Russia, South Korea, Thailand, Taiwan, and others have recorded double-digit gains in the value of their reserves as well. The big reason reserves have grown is that central banks are buying dollars–which make up 62 percent of all foreign reserves–to slow the appreciation of their currencies and keep exports robust. The strategy has hardly been a complete success, as currencies from the baht to the peso have strengthened. Yet these currencies would have risen even more had the central banks not acted.



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Caterpillar cozies up to suppliers page 22 ▶

bers is unrelenting. European countries where women have fewer than two children, on average, have to keep bringing in non-Europeans to maintain their populations, living standards, and pensions, says André Sapir, an economics professor at the Université Libre de Bruxelles. "Eastern Europe is not going to be the reservoir of labor that Southern Europe ceased to be in the 1970s," he says. "It can't replace North Africa." —*Gregory Viscusi with Tony Czuczka, Marion Rae, and Laura Litvan*

The bottom line *Anti-immigrant feeling is running high in the West, yet the economic need for immigrants' labor and spending power remains strong.*

Monetary Policy

China's Rate Hike Is Just The Beginning

▶ More moves to curb inflation are expected as consumers fret

▶ "Beijing would like slightly slower but better-quality growth"

China's surprise decision to raise interest rates for the first time since 2007 was as much a political move as an economic one. Policymakers are worried that economic growth plus food, labor, and property prices all threaten to get out of hand. The government also wants to show riled-up Chinese consumers that it is doing something about the ever-higher inflation rate, which could hit 3.6 percent in September—the fastest pace in almost two years. "This sends a signal from the Party to the people that they are concerned," says CLSA Asia-Pacific Markets China analyst Andy Rothman.

The trick is getting the balance right. "Beijing would like slightly slower but better-quality growth"—maybe around 8 percent, Rothman says, rather than his estimate of more than 10 percent for 2010. A massive rate hike, though it could smother inflation, would send property prices plunging and dent gross domestic product. Hence the fairly tame rise in the benchmark one-year lending rate to 5.56 percent from 5.31 percent, Meanwhile, savings deposit rates will go to 2.5 percent from 2.25 percent—enough to juice savers' income yet not enough to offset fully the effects of inflation.

The rate hikes will pressure banks to curb lending. New loans in September reached 596 billion yuan ($89 billion), higher than the 450 billion yuan consistent with meeting this year's lending quota, as Capital Economics economist Mark Williams pointed out in an Oct. 19 note to investors. Earlier efforts to cool the property market, including tougher down-payment requirements and more loan restrictions, have not paid off. That's why analysts expect more rate hikes to boost the quality of loans. Deposit rates are expected to go up, too, since consumers don't want to see inflation eat away at their savings forever. —*Dexter Roberts with Li Yanping*

The bottom line *China's surprise rate hike may be the first step in a long process to curb lending and inflation, without sacrificing growth.*



Banking in Beijing: The rate hike is a sign that lending will cool down

Emerging Petro-States

New Rules for Tapping Africa's Abundant Oil



▶ The oil fields are tempting, the governments hard to deal with

▶ "Interference in Uganda and Ghana is a major concern"

Oil producers led by **ExxonMobil**, **Chevron**, and London-based **Tullow Oil** have spent billions in their quest for new crude in sub-Saharan Africa. Now their expected flow of profits is at risk as African governments tighten control of the industry.

From 1989 to 2009, sub-Saharan Africa's estimated oil reserves more than doubled, to 127.7 billion barrels, equivalent to about 9.6 percent of the world's total, according to **BP**. Along the West African coast, Liberia, Gabon, and Sao Tomé and Principé have invited bids for exploration licenses. In the interior, the geological formations that stretch from Mauritania to northern Namibia may hold 71.7 billion barrels of undiscovered oil, according to U.S. Geological Survey estimates. "There is plenty of interest," says Martin Kelly, head of sub-Sahara Africa research at energy consultants Wood Mackenzie.

Explorers are also struggling to hold onto licenses and avoid ending up with less favorable contracts as governments once eager to accommodate Western oil companies seek to reassert authority over their natural resources and satisfy voters. In Nigeria, for example, oil companies expect that by yearend a new oil law will be in place that will increase taxes and royalties from oil production. Foreign companies say the levies may make investment in offshore fields unprofitable. "Governments are under much more pressure to make demands in terms of oil revenue coming into the national coffers," says Rolake

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Akinola, a London-based Africa analyst at Eurasia Group.

In August, Ghana blocked ExxonMobil's $4 billion bid to buy a stake in its deepwater Jubilee field from Dallas-based **Kosmos Energy**. A tax dispute has held up Tullow's plans to start pumping from fields in Uganda. "Government interference in Uganda and Ghana is a major concern," says Dougie Youngson, an analyst at Arbuthnot Securities in London. "This is all part of the pattern of operating in Africa."

Kosmos, which is backed by **Blackstone Group** and **Warburg Pincus**, has been accused of breaking the terms of its contract by attempting to sell assets to ExxonMobil without the consent of Ghana's national energy company, a charge Kosmos denies. "Ghana supports investors like ExxonMobil coming to Ghana," Deputy Energy Minister Emmanuel Armah-Kofi Buah says. "But our laws also have clear requirements that must be met."

In Uganda, Tullow paid **Heritage Oil** $1.5 billion in July for control of two licenses. Final approval has been held up until the government and Heritage agree on how much capital-gains tax Heritage owes. Both Tullow and Uganda hope the tax row will be resolved soon.

In June, Congo nullified a 2006 agreement with Tullow and handed two exploration permits to companies owned by South African President Jacob Zuma's nephew. Congo will struggle to attract "legitimate" investment if it doesn't honor contracts in a transparent way, Tullow said at the time. The company has won a temporary injunction against the development or resale of the disputed licenses.

One strategy for smaller operators in sub-Saharan Africa may be to find the oil, then sell the discoveries to the majors or the Chinese. "You don't necessarily have to go into full development," says Thomas P. Cross, the outgoing chief executive officer of **Dana Petroleum**, a midsize British explorer, which has just been acquired by **Korea National Oil**. "The best way to maximize return to shareholders is to explore in these countries, but to produce cash in more politically stable areas." **B**

—Eduard Gismatullin

The bottom line *Governments in sub-Saharan Africa are asserting their control over the region's oil wealth in a series of disputes with Western oil companies.*

Seven Days

by Ira Boudway

25

Fed Chairman Ben Bernanke speaks at a housing conference in Virginia

EU foreign ministers meet in Luxembourg

▶ **U.S. existing home sales for September:** Surveyed economists expect the annual sales pace to continue to climb from a record low in July.



26

NBA season begins

U.K.'s third-quarter GDP preliminary estimate



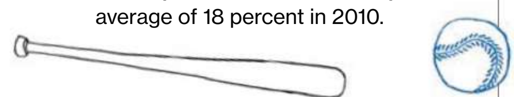
▶ **Mitt Romney in Iowa:** The former Massachusetts governor returns to the state where he finished second in the 2008 Presidential caucuses to campaign for state Republicans.

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Major League Baseball's World Series begins

Earnings reports from ADP, Allstate, Comcast, ConocoPhillips, Office Depot, Sprint Nextel, and Visa

▶ **Procter & Gamble earnings report:** The world's largest consumer-products maker has increased monthly retail sales in China by an average of 18 percent in 2010.



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Mexico's Leading Economic Index

Earnings reports from Dow Chemical, Microsoft, OfficeMax, Sunoco, and 3M

▶ **ExxonMobil earnings report:** Profits could jump more than 50 percent, to $7.2 billion, the biggest third-quarter increase in six years.

▶ **Art Toronto 2010:** Over 100 galleries exhibit at the city's 11th annual fair.

29

U.S. third-quarter GDP advance estimate

Japan's vehicle production and housing starts for September



▶ **Euro zone unemployment:** The jobless rate has been stuck at 10.1 percent, the highest since 1998, for four months.

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Tottenham Hotspur visits Manchester United at Old Trafford

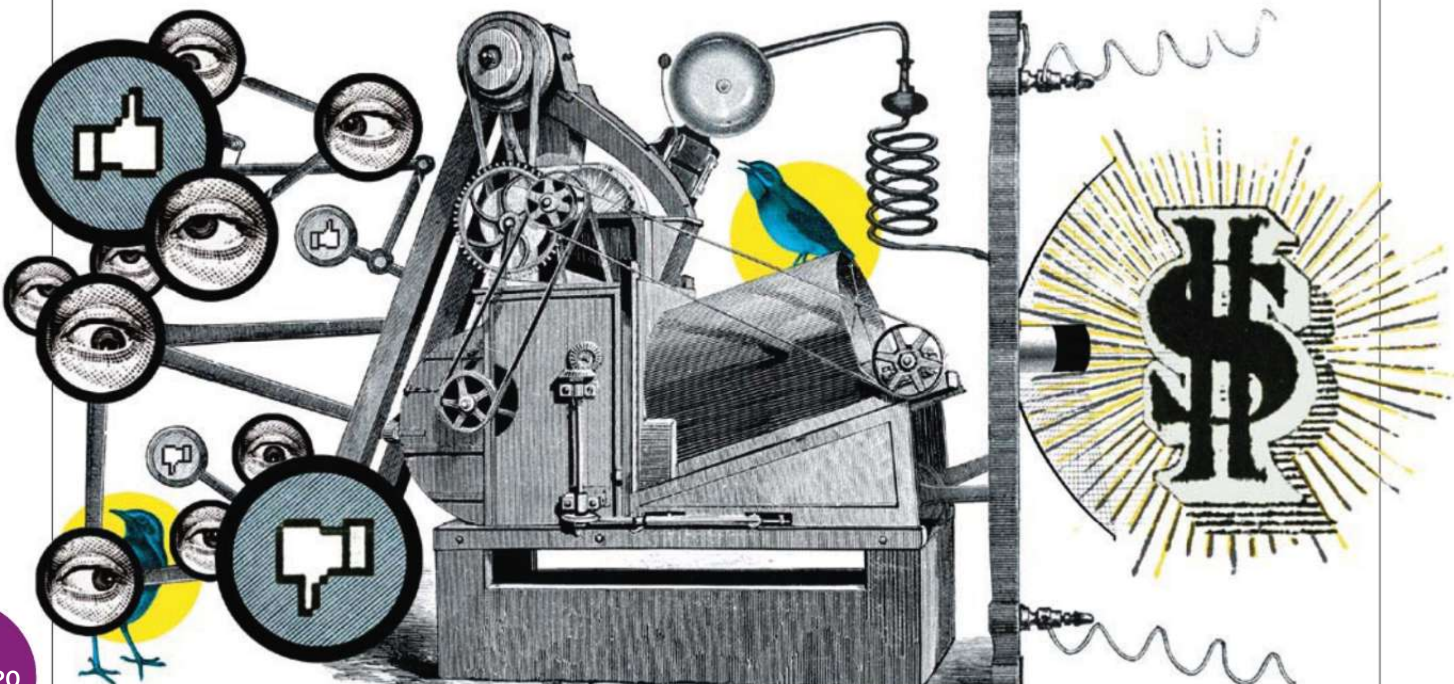
▶ **The Rally to Restore Sanity:** *Daily Show* host Jon Stewart invites his audience to gather on the National Mall in Washington, D.C., in support of "respectful disagreement."

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▶ **Georgia gubernatorial debate:** Democrat Roy Barnes, Republican Nathan Deal, and Libertarian John Monds square off in Atlanta.

For more events and interactive content, visit Businessweek.com.



The Big Business of Sifting Through Social Media Data

▶ **Demand grows for firms that help companies decipher the online chatter about products**

▶ **"Companies need to acknowledge that this social dialogue will occur whether they like it or not"**

Jonathan Spier, chief executive officer of social media analytics company **NetBase**, had the chance in early 2009 to win a multimillion-dollar contract for his 25-person firm if he could answer one question: Why do men sport stubble?

The query, posed by a consumer-products company to more than 100 research firms, had to be answered by mining millions of postings by men on social media sites. NetBase's software, which reads and analyzes 50,000 sentences a minute, found 77,000 mentions of stubble online in less than six seconds. Its researchers isolated all the positive comments, categorized them into themes, and built a chart in less than an hour ranking all the reasons. While the answer—most men wear stubble because they perceive it to be sexy—isn't that eye-opening, the ability to quickly collect and analyze all that Web data is. The process provides something marketers have long wanted: a way to pick up intelligence and trends from among all that chatter floating across the Net.

"It's all oriented around what businesses need and want from information," said Spier, whose Mountain View (Calif.)-based company now employs 50 people and works with **Coca-Cola**, **Kraft Foods**, and **Procter & Gamble**. "That's our selling point."

Companies are expected to more than double the amount they're spending for online data, to $840 million in 2012 from last year, according to marketing consultant Winterberry Group. The prospect of such fast-growing revenue is one reason social media monitoring outfits are being snapped up by larger software and market-research firms intent on improving their ability to use **Twitter**, **Facebook**, and blog postings as windows into the thinking of consumers.

"For years advertising was one-to-many, and then there was all this big hoopla about how to do one-to-one advertising, with the advent of the Web and Web metrics," said Debbie DeGabrielle, chief marketing officer of Visible Technologies, a social media analytics company that has grown 18-fold since 2006. "Social intelligence is the iteration beyond that—it is not mass personalization, it is personalization one-to-one."

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Companies&Industries

Advertisers in the U.S. are getting the message. They will increase their spending on social media sites by 24 percent next year, to $2.09 billion, according to researcher eMarketer in New York.

Using the Web to collect information more quickly can help companies avoid product disasters. When Coca-Cola released New Coke in 1985, it committed one of the biggest blunders in marketing history, "spawning consumer angst the likes of which no business has ever seen," the company says on its website. Three months later, Coke returned its original soda to the market. Stan Sthanunathan, Coke's vice-president of marketing strategy and insights, doubts it would have taken that long to react in today's Web-connected world. "Back then, people had to write letters and send it to us, saying 'please bring back old Coke,'" Sthanunathan said. "It came out in large numbers, but it came after a few days. Right now, people will tell you that in a matter of two minutes on their Facebook page."

Gap experienced such a reaction earlier this month when it briefly replaced its iconic blue box with a new logo. The design was widely panned online, and the retailer yanked it a week later. "We did not go about this in the right way," said Marka Hansen, the Gap president for North America. "We recognize that we missed the opportunity to engage with the online community."

That realization is fueling a buying spree of companies specializing in Web analysis. **Nielsen** acquired BuzzMetrics in 2006. TNS Media Intelligence, which bought Cymfony in 2007, was subsequently purchased by the Kantar Media unit of **WPP Group**. The **McGraw-Hill Companies**' J.D. Power & Associates acquired Umbria in 2008. But it was **Adobe Systems**' purchase of Omniture for $1.8 billion last year that really put social media analytics in the spotlight, said John Lovett, a senior partner at Web Analytics Demystified. "That helped to a great extent to put our industry on the map," he said. Total acquisitions in the industry have since reached $2.5 billion, Lovett said. Last month **comScore** bought Amsterdam-based Nedstat for $36.7 million.

"A big part of this is large research companies, the billion-dollar players, realizing they need to fill out their portfolios," said Joel Rubinson, president of Rubinson Partners, a research consulting firm. "You want to have a complete offering for a global client."

Traditional market research, which involves surveys or focus groups, can be backward-looking or shaped by the questions asked, instead of tapping into what consumers themselves want to discuss or comment about online, Rubinson said. Explains Visible Technologies' DeGabrielle: "Companies need to acknowledge that this social dialogue will occur whether they like it or not, without their ability to control it. But they can choose to participate in it."

Still, monitoring social media for insights doesn't always uncover the next big thing. NetBase, for example, said it discovered a large online community of long-distance bikers and other endurance athletes purposely drinking Coke that had gone flat—giving them the caffeine and sugar to boost stamina but none of the carbonation, which can lead to cramps. NetBase researchers thought it was a cool Web-generated insight into an unusual use for the ubiquitous cola. The only problem: Coke managers had figured that out on their own.

—*Ryan Flinn*

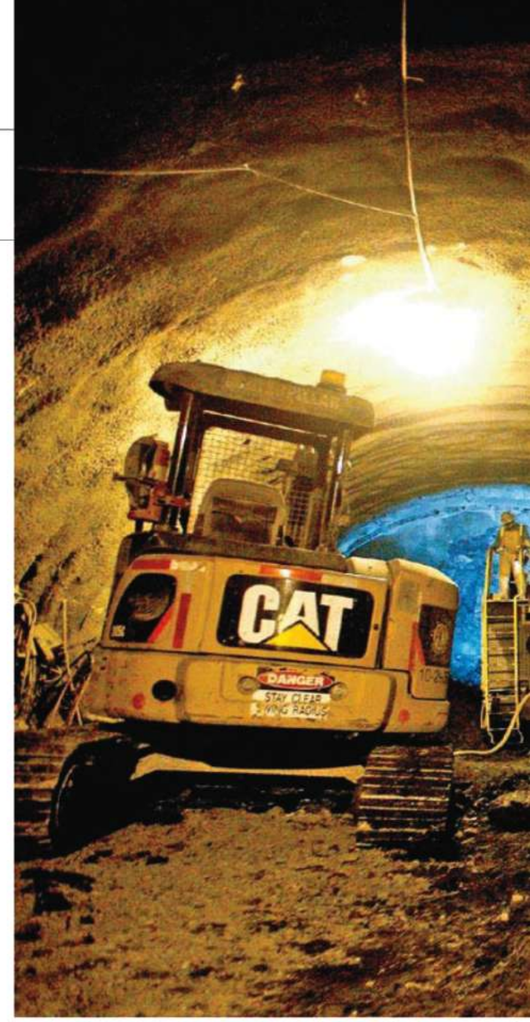
The bottom line *The business of collecting and decoding online chatter at social networking sites is growing fast—and attracting buyout offers.*

100

MILLION DOLLARS

The annual savings Sirius XM Radio would realize if it can't renew its contract with radio host Howard Stern. The five-year deal expires in December.

DATA: BLOOMBERG



FROM TOP: KEN JAMES/BLOOMBERG; HARRY HOW/GETTY IMAGES

Manufacturing

Caterpillar Looks for A Few Close Friends

▶ It hopes teaming up with suppliers will boost earnings

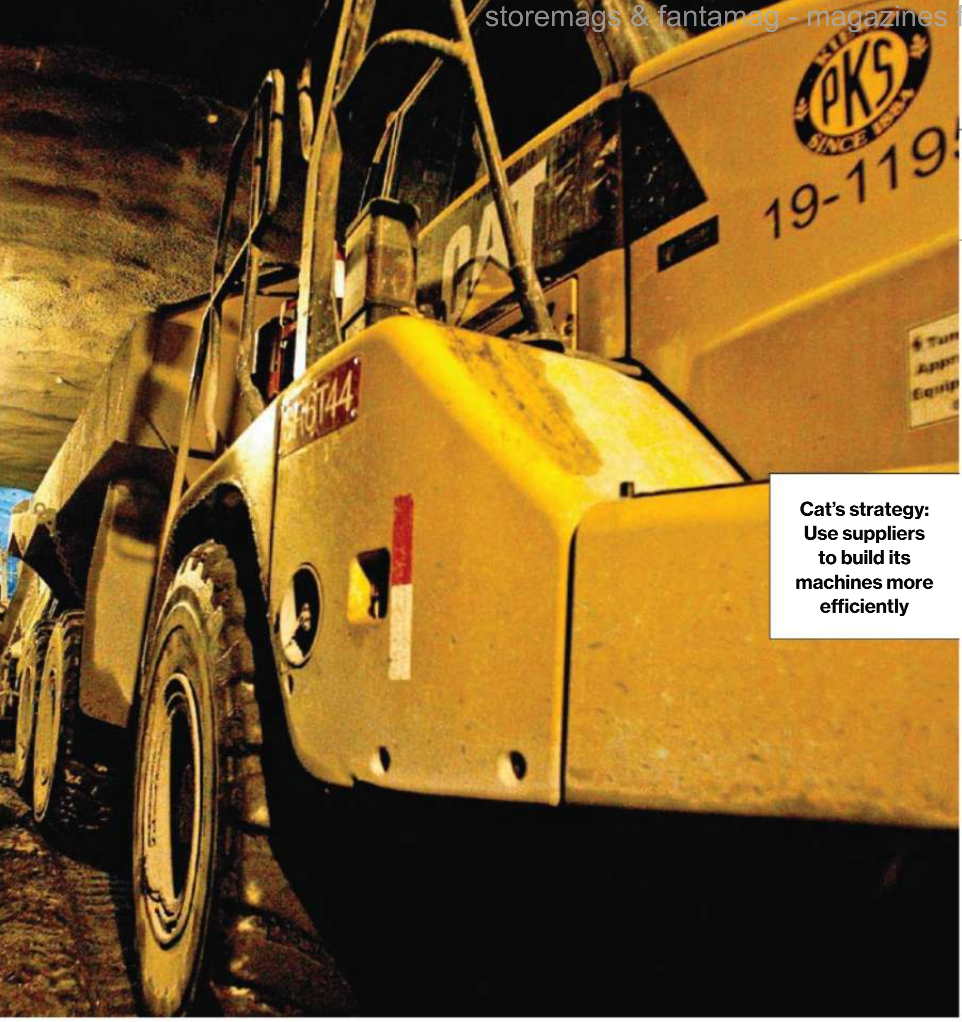
▶ "If we get that right, the profit pulls through pretty quickly"

Mike Render, an engineer who has worked for **Caterpillar** since the 1970s, has spent the last three years trying to break with the company's past. Render suggested his employer partner with a supplier to design a component that cuts emissions, rather than simply dictate specifications and choose the cheapest vendor. His team ended up working with 12 engineers and managers of catalytic-converter manufacturer **Tenneco.** At Caterpillar's Mossville (Ill.) engine center the team created a mock production line to work out kinks in the manufacturing process. Using the joint design, assembling the component at a Tenneco plant in Nebraska cut Caterpillar's costs on the part by 20 percent.

The collaboration is a cultural shift for Caterpillar, whose suppliers in the

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Cat's strategy: Use suppliers to build its machines more efficiently

past have complained about a lack of dialogue, says Stephen Volkmann, an analyst at Jefferies & Co. "It was, 'Give me what I want when I want it, and the rest is your issue to manage,'" he said. "The big change in attitude is from the servant-master relationship to more of a team-type relationship."

Caterpillar, the world's largest maker of construction and mining equipment, expects the Tenneco collaboration to become a benchmark, says Chief Executive Officer Douglas R. Oberhelman, who succeeded James W. Owens in July. The company is shrinking the number of suppliers it relies on to 6,000 from 9,000 and is working more closely with 200 companies it has identified as critical to its growth.

Improving the supply chain is a key piece of Oberhelman's strategy to pull 25¢ of profit from each new dollar of sales as demand in emerging markets surges. He plans to apply engineering and quality-control expertise from suppliers inside Caterpillar factories to help build the company's signature yellow-and-black machines more efficiently.

Caterpillar wasn't prepared for the last increase in global demand, from 2006 to 2008, and the mistake proved costly. Sales rose 24 percent during that period while profit growth was flat as Cat paid more for raw materials and faster delivery of parts from suppliers. "In the next cycle, Caterpillar wants to have a better playbook," said Larry De Maria, an analyst at Sterne Agee. "It's critical that they have [enough] wheels, tires, bearings, and everything else, which is essential to maximizing returns to shareholders, return on capital, and operating margins."

Oberhelman knows Cat must change, and he's appointed an outsider with a "deep background in supply-chain collaboration," as his new chief procurement officer. Frank Crespo, who previously held that post at **Honeywell International**, started work in August. "We are still a bit behind in our supply-chain efficiency," Oberhelman said. "If we get that right, the profit pulls through pretty quickly."

Caterpillar may not have needed to focus on collaborating with suppliers in the past because of its size and dominant position in the industry, said John W. Henke Jr., president of Birmingham (Mich.) Planning Perspectives, which advises manufacturers on supplier relationships. Now, "competition is going to be based on the supply chain, not an individual company," said Henke, who has developed an index that quantifies buyer-supplier relations. "Toyota and Honda are good because of their supply chain and great supplier relations."

In Planning Perspectives' ranking for automotive supplier relations this year, **Honda Motor** was the leader, followed by **Toyota Motor**. Both have also fared better financially than some other carmakers during the downturn.

Henke said improving relations with suppliers entails communication and engendering trust that spurs vendors to give manufacturers their best technology. Depending heavily on suppliers can present pitfalls. **Boeing** in August postponed the first delivery of its 787 Dreamliner aircraft to early 2011 partly because of **Rolls-Royce Group**'s inability to supply an engine for flight tests. Boeing is also working through quality issues in body sections built by **Finmeccanica**'s Alenia Aeronautica.

Caterpillar's collaboration model isn't "the absolute Japanese definition," Oberhelman said. "It's [also] not the American automotive supplier collaboration, where it's price cuts, costs down, and then you go bankrupt together. We are trying to find a spot in the middle."

Tenneco's experience building parts that reduce emissions for the automotive industry has benefited Caterpillar, Render said. The partners reduced the complexity of the device they worked on. They made two versions of a part used to burn soot in the emission-reduction device for Caterpillar's various machines, compared with the 43 versions made by Caterpillar in 2007 just for truck engines, which it also makes. "It's a bit like playing a Rubik's cube," said Render, a Caterpillar product

Tweeted

"We're filling in the baseball void for those without Fox-Cablevision. Matt Cain pitching a beauty. SF up 3-0."
—A post from The FCC's Twitter feed during Game 3 of the National League championship on Oct. 19. About 3 million Cablevision customers can't view the series due to a rate dispute between Fox Television and the cable operator



Companies&Industries

manager. "If we do this, what will happen? If we do that, what will happen? They helped with the innovation. Tenneco has given us a model" of how collaboration should occur.

The device Caterpillar and Tenneco worked on to reduce diesel emissions, as required under federal law starting next year, will be used in about 100 Caterpillar models including various types of excavators, backhoes, wheel loaders, and bulldozers. "When we come up with what we think is a pretty great technical innovation, the first guys we talk to are the guys at Caterpillar," says Brent Bauer, a senior vice-president who oversees the project for Tenneco. "When you have everybody in the same room, there are some magical things that happen. We get great products. We optimize costs and we add speed." —*Shruti Date Singh*

The bottom line *In a bid to boost profits, Caterpillar is increasing collaboration with its suppliers. That's a culture shift for the big equipment maker.*

Green Business

The Sun Doesn't Shine On Green Stadiums

▶ Solar panels at sports facilities generate more goodwill than power

▶ Some owners eschew solar "when they can upgrade their suites"

The Orlando Magic opens its season on Oct. 28 at the first new National Basketball Assn. venue that will earn LEED certification from the U.S. Green Building Council. Last month the NBA joined four other major U.S. sports leagues in announcing an initiative to encourage teams to use solar energy at their facilities. Yet the $380 million Amway Center's resource-saving features—more-efficient climate control, low-flow toilets, rainwater recycling, and preferred parking for hybrid cars—don't include solar panels. Why doesn't an arena on the cutting edge of sustainable design in the southernmost state on the mainland have a single panel? Solar doesn't pay.

"I don't think the return on investment has gotten to the point where it makes [solar] a reasonable addition," says Mike Wooley, who specializes in arena management for Populous, the city of Orlando's operational consultant for the Amway Center. "Owners are putting their money in other technologies, like water conservation toilets and energy management technology, that drive down costs."

Robert Rayborn, a project manager at **Turner Construction**, which oversaw the building of Amway, says that even if they had covered every available inch, solar panels would have had a negligible impact during the arena's peak demand periods. "You just can't justify to owners and city officials that there's an economic advantage," he says. Return on investment usually takes at least 10 years, according to Scott Terry, an electrical engineer with the design firm Smith Seckman Reid, which worked on Amway. "A lot of owners don't want to pay for that when they can upgrade their [luxury] suites."

Besides the slow payback, solar panels compete for space with revenue-generating corporate logos that are often splayed across arena roofs and reduce their load-bearing capacities—a prized commodity for concert engineers seeking to hang hundreds of thousands of pounds of sound and lighting gear from trusses.

Solar arrays are in place at only a handful of sports venues: AT&T Park in San Francisco, Coors Field and the Pepsi Center in Denver, and Progressive Field in Cleveland. These installations supply a small fraction of the facilities' power needs. (Fenway Park in Boston also has solar panels that help heat the park's water, providing 37 percent of the heating load, rather than produce electricity.) The Progressive array—1,300 square feet of panels mounted on a pavilion on the upper deck in 2007—cost $180,000 to install and has provided a total of 29,000 kilowatt hours over the past three years. Progressive uses approximately 17 million kwh per year, enough juice to power more than 1,500 American ➜

Management

From the Board Room to the Corner Office

Choosing a CEO is a key role of boards, and increasingly they're tapping one of their own. The number of directors-turned-CEO tripled in the past year, according to recruiter Heidrick & Struggles. Here are some named in 2009-2010.



CEO	Company	Tenure as Director
Daniel Akerson	General Motors	1.1 years
Fred Chang	Newegg	9.6 years
Alan Bennett	H&R Block	1.8 years
Douglas Tough	International Flavors & Fragrances	1.4 years
William McCracken	CA Technologies	5 years
Michael Carpenter	Ally Financial (formerly GMAC)	.5 years
J. Raymond Elliott	Boston Scientific	1.9 years
Jay Johnson	General Dynamics	6.2 years
Patti Hart	IGT	2.8 years
David Dyer	Chico's FAS	1.8 years

DATA: HEIDRICK & STRUGGLES' GLOBAL CEO AND BOARD PRACTICE

ILLUSTRATIONS BY ANDY FRIEDMAN

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warm houses love energy bills

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Races to watch on election night page 36? ▶

homes. “It’s really a demonstration piece,” says Cleveland Indians’ spokesman Brad Mohr, noting the real-time meter on the park grounds that allows fans to monitor output.

The only sports venue in the U.S. with a solar installation that supplies at least 2 percent of its power is the Staples Center in Los Angeles, home of the NBA’s Lakers and Clippers and the National Hockey League’s Kings. The Staples Center’s owner, sports and entertainment operator **AEG**, installed a 25,000-square-foot array in October 2008 at a cost of $2.3 million. The 1,727 panels supply 456,000 kwh of electricity per year out of the arena’s demand for 21 million kwh. At 12¢ per kwh, AEG saves about $55,000 a year. At that rate, the array would take more than 40 years to pay for itself. AEG says that with the help of utility rebates and federal tax credits it expects to recoup the investment in 8 to 10 years.



The Staples Center could take 10 years to pay for its solar panels

The questionable economics haven’t stopped everyone from taking the solar plunge. There are substantial solar arrays in the works at the US Airways Center in Phoenix, Pocono Raceway in Pennsylvania, and Qwest Field in Seattle. For now, however, U.S. sports venues continue to draw almost exclusively from existing power grids.

Allen Hershkowitz, a senior scientist at the National Resources Defense Council and the driving force behind the sports solar push, doesn’t expect much to change soon. Still, he believes the small efforts under way can have an outsize impact. When Ronald Reagan became President, Hershkowitz notes, he removed the solar panels that Jimmy Carter had installed on the White House. “He did it because of a cultural message,” Hershkowitz says. “So we see the alternative happening—solar panels on Fenway, on the Staples Center, and in Cleveland. We start to get a different cultural message.” *—Ira Boudway*

The bottom line *Sports leagues are encouraging teams to go solar at their stadiums. So far, the return on investment isn’t big enough to entice owners.*

Food Industry

Greek Yogurt Isn’t a Subculture Anymore

▶ Giants like Kraft and General Mills are taking on tiny dairy makers

▶ “The yogurt aisle had been so boring,” says Chobani’s founder

There’s a Greek uprising taking place along the dairy aisle. A specialty item just a few years ago, creamy Greek-style yogurt has turned into a supermarket staple. The trend has food giants such as **Kraft Foods** and **General Mills** trying to topple a pair of tiny dairy makers who until recently had the market mostly to themselves.

Kraft Foods, which abandoned yogurt entirely in 2004, began selling its new Athenos brand Greek yogurt at **Wal-Mart Stores** in September and plans to expand to other major grocers nationally by early next year. General Mills introduced Yoplait Greek yogurt in March. Both are chasing a massive market share lead enjoyed by Greek yogurt brands Chobani and Fage.

Greek yogurt—made by straining out whey and water from traditional yogurt—has been around for centuries. With a thick consistency and a sour flavor often balanced with fruit or honey, the Greek variety has won plaudits from nutritionists for its high protein and low fat content. That combination has caught fire with health-conscious consumers: Greek yogurt sales have doubled every year since 2006, according to Marshall Hyzdu, brand manager for Kraft’s Athenos line, a leading maker of feta cheese and hummus. “Our consumers were begging us to launch it,” he says.

For market leader Chobani, a dairy maker that has seen its U.S. sales more than triple in the past year, to $196 million, success came almost by chance. In 2005, founder Hamdi Ulukaya, 38, was smoking a cigarette and thumbing through a pile of mail at his Euphrates feta cheese plant in Johnstown, N.Y., when he came across a postcard advertising a yogurt plant for sale in a nearby county. He tossed it.

Then Ulukaya’s thoughts turned to the strained yogurt the native Turk had enjoyed in his youth. So he fished the tea-stained card out of the garbage. The plant, he saw, had just been closed by Kraft. “The yogurt aisle had been so boring,” says Ulukaya. “Everything else is the sugary, same base that it’s been for a long time.” Now his products can be found at **Kroger**, **Whole Foods**, and **Target**, alongside old standbys like Dannon and Yoplait.

Greek yogurt’s popularity has been driven in part by a change in American eating habits. More people are switching to yogurt for breakfast instead of cereal, according to UBS analyst David Palmer, with sales overall up 7.8 percent over the past year. There’s still room to grow: U.S. consumers eat less yogurt per person than their counterparts in the U.K., ➔

Percent change in U.S. sales, 52 weeks ended Oct. 3 goto storemags.com

YOPLAIT ORIGINAL YOGURT	FAGE TOTAL YOGURT	OIKOS YOGURT	CHOBANI YOGURT
–2%	57%	88%	246%



DATA: SYMPHONYIRI GROUP

ELECTION NIGHT RACES, FROM LEFT: GETTY; REDUX; GETTY; ZUMA PRESS; REDUX; ZUMA PRESS; REUTERS; NEWSCOM. STAPLES CENTER: AEG

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Australia, and Canada, says Kendall J. Powell, chief executive officer of Yoplait-maker General Mills.

Kraft sold its yogurt business, including the Breyers and Light'n Lively brands, six years ago to focus on faster-growing products like Oreo cookies. Now it's back with Athenos, which comes in five flavors including honey, strawberry, and blueberry. The packaging is similar to Fage's, with separate compartments for the yogurt and the fruit flavor. General Mills' Yoplait Greek package puts the biggest emphasis on letting shoppers know that it has two times the protein of regular yogurt. Flavors include strawberry, blueberry, honey vanilla, and plain. **Stonyfield Farm** dominates the organic market with its three-year-old Oikos brand. The Londonderry (N.H.)-based company also recently added a "natural" Greek version under its Brown Cow brand.

For pure pedigree, the one to beat is Fage (pronounced fa-yeh), which is No. 2 in the market. The family-run Fage's roots reach back half a century to a small dairy shop in Athens. The company began exporting its yogurt to the U.S. in the late 1990s—and then built a production facility in New York State. To win over more health converts and reach yogurt's main demographic—women—Fage has run ads in fashion magazines such as *Vogue* and *Elle*. It also advertises online, with banner ads on *The New York Times* website, and at the Huffington Post and *Food & Wine* sites. Fage's yogurt sales totalled nearly $123 million in the 52 weeks ending Oct. 3, a more than 50 percent increase on the same period a year ago, according to SymphonyIRI Group data from supermarkets, drugstores, and mass merchandisers, excluding Wal-Mart.

Chobani's Ulukaya says he now regularly fields buyout offers for his company: "I've said 'no' in so many different languages." And though he knows that sales cannot keep growing at their current clip, he's doing his best to keep up the momentum. Chobani recently added a Champions line for kids with flavors such as Verryberry and Chocolate.

—Duane D. Stanford and Matthew Boyle

The bottom line *Small companies won fan early fans for Greek-style yogurt. Now food giants Kraft and General Mills have launched their own brands.*

Briefs

by Caroline Winter

Volkswagen
Planned Porsche merger in jeopardy



Volkswagen's merger with Porsche, originally set for 2011, may be put on hold because of pending U.S. lawsuits and German tax disputes. Porsche is being sued by U.S. hedge funds for allegedly manipulating markets during its failed attempt to acquire a controlling stake in VW in 2009, which ultimately resulted in a reverse takeover. Courts will decide in January whether to let the case go forward. The German companies' plans are also hampered by legal requirements that would result in higher taxation if the merger takes place before 2014. VW currently owns 49.9 percent of Porsche.

Massey Energy
Mulling a possible sale

Massey Energy, owner of the Upper Big Branch coal mine in West Virginia where 29 people died in an explosion last April, is considering putting itself up for sale. Shares in the Richmond (Va.)-based company—the nation's No. 6 coal producer—rose 5 percent on Oct. 19, the day *The Wall Street Journal* broke the news. Massey posted a loss of $88.7 million for the second quarter, due in part to repairs and anticipated legal costs resulting from the April explosion. Massey's management has warned that there will be more red ink this year. The company will be idling its underground mines for two shifts to conduct safety training, after a surprise visit by federal inspectors turned up violations.

Intel
Upgrading U.S. facilities

On Oct. 19, Intel announced plans to invest between $6 billion and $8 billion to upgrade its U.S. manufacturing facilities and build a new fabrication plant in Oregon. The Santa Clara (Calif.)-based chip giant is pushing to stay ahead of competitors in producing 22-nanometer microprocessors that will allow for sleeker device designs and longer battery life at lower costs. According to Intel, the new outlays will create up to 8,000 construction jobs and up to 1,000 permanent high-tech jobs.

Goldman Sachs
Taking a pay cut

$13.1 BILLION

Goldman Sachs has set aside $13.1 billion for compensation and benefits in the first nine months of the year, down 21 percent from a year earlier, as revenue fell 14 percent. The amount, equal to 43 percent of revenue, is enough to pay each of the firm's 35,400 employees $370,706 for nine months of work. That's down from an average of $527,192 for the firm's 31,700 workers in 2009. The company cut its full-year ratio of compensation to revenue to 35.8 percent, the lowest since it went public in 1999.

Allergan
Botox approved for migraines

Allergan has won approval to sell its wrinkle-smoother Botox as a treatment for chronic migraine headaches in the U.S. The drug's annual sales could double, to $2.3 billion, as a result, says Sanford C. Bernstein. In early October, Allergan reached a $375 million settlement with the Justice Dept. on charges that it marketed Botox for unapproved uses, including pain relief. In one independent health study, patients taking Botox suffered 9 fewer days of headaches per month, compared with 6.7 fewer for those on a placebo.



On the Move

Aetna **President Mark T. Bertolini will take the reins from CEO Ronald A. Williams next spring** ● ***Chicago Tribune*** **CEO Randy Michaels resigns** ● **Borders** **Former casino executive Scott Henry named CFO**

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Alice Rivlin

Rivlin's Quest to Wind Down Trillion-Dollar Deficits

▶ Her rump group of budget hawks hopes to break the impasse on Obama's deficit panel

▶ "The difference is that none of us are running for public office"

Alice M. Rivlin, the grande dame of budget politics, is trying to pull off the Washington equivalent of a triple backflip off the high board. Appointed by President Barack Obama to the bipartisan commission named to recommend ways to rein in the runaway deficit, the 79-year-old says the group is paralyzed by politics six weeks before its report is due. The panel has all but taken Medicare, one of the biggest deficit drivers, off the table because the issue is radioactive, given this year's health-care reform struggle. Most Republican members are dead-set against tax increases, most Democrats have drawn a bright line around Social Security, and no serious negotiations are taking place while midterm election mud still flies.

Rivlin is adopting a tactic that broke a similar stalemate in January 1983, when the National Commission on Social Security Reform disintegrated in partisan bickering. Then-Senator Daniel P. Moynihan, a New York Democrat, walked across the Senate floor to Republican Bob Dole of Kansas, the chairman of the Senate Finance Committee, and said: "Bob, we can't let things end this way," says Steve Bell, who was close to the discussions as the Budget Committee chief of staff. The two lawmakers then formed a rump group that crafted a deal, which President Ronald Reagan signed into law three months later, to raise the cap on payroll taxes and the retirement age.

Hoping history will repeat itself, Rivlin is leading what some call a shadow deficit commission with Bell's ex-boss, former Senator Pete Domenici (R-N.M.). It's sponsored by the Bipartisan Policy Center, a think tank started by former Democratic and Republican Senate majority leaders, and partially funded by the Rockefeller and Peterson foundations. The commission meets regularly at the center's Washington office.

Also on the panel are James Blanchard, a former Democratic governor of Michigan, and Donald Marron, director of the Congressional Budget Office in 2005, when Republicans still controlled Congress. They have joined 15 other budget hawks to devise a plan they hope will serve as a model if the President's commission deadlocks, as many predict it will. The Obama panel requires approval from 14 of its 18 members to recommend ways to balance the budget by 2015, excluding interest on the debt. The ad hoc group, which predates the real deficit commission, is working on a plan that will ad-



Pete Domenici

FROM TOP: BRENDAN HOFFMAN/BLOOMBERG; MANNIE GARCIA/BLOOMBERG



In the right corner: *Glenn Beck, emcee of the Restoring Honor rally that he says attracted 500,000 Tea Party stalwarts and other supporters to Washington in August. In the left: Jon Stewart, the faux anchorman who plans to host an Oct. 30 Rally to Restore Sanity in the capital. Who's more popular? Stewart has the edge, according to a Bloomberg National Poll of 1,000 adults. Stewart, the host of Comedy Central's* Daily Show, *gets a favorable rating from 37 percent of poll respondents. Beck, the Fox News host, is viewed favorably by 28 percent.* —Nicholas Johnston

dress the taboos the Obama commission is skirting, including raising taxes and cutting Social Security and Medicare, Rivlin says. Making those tough choices is easier for her group, she says, because it counts no elected officials. "We are a similar-size group and also very dedicated to getting a solution," says Rivlin, a senior fellow at the Brookings Institution in Washington and a former Federal Reserve vice-chairman. "The difference is none of us are running for public office."

The official panel, chaired by former Senator Alan K. Simpson (R-Wyo.) and Erskine B. Bowles, former President Bill Clinton's chief of staff, has a Dec. 1 deadline. Rivlin's group plans to unveil a proposal on Nov. 17, giving the official commission time to study it. "We hope we can influence the last-minute deliberations the same way that the '83 commission ... came back together," says Bell, now a visiting scholar at the Bipartisan Policy Center. Bruce Reed, director of the real commission, denies it has given up on health care, yet agrees it will be tough. "It will be harder to reach a supermajority on that issue than on any other," he says.

By all accounts, the U.S. budget deficit is on an unsustainable path. It was $1.29 trillion, or 8.9 percent of the total economy, in fiscal 2010, which ended on Sept. 30. Debt held by the public, now $9.2 trillion, or 63 percent of gross domestic product, is projected to reach $18.5 trillion, or 78 percent of GDP, by 2020, according to the Office of Management and Budget. Between 1960 and 2000, debt averaged 37 percent of GDP. Interest payments could reach $1 trillion a year within a decade.

Failure to seriously address the debt could undermine would-be lenders' confidence that the U.S. government can make good on what it owes. That might force the Treasury to borrow at higher rates, triggering a downturn that would bring greater unemployment, stagnant wages, and ever more debt.

The shadow panel, Rivlin says, won't be afraid to sound the alarm. While Medicare is likely a no-go for the actual commission, she says her group will put it front and center. Medicare spending, at $519 billion, or 3.6 percent of GDP this year, is projected to hit $929 billion by 2020, the CBO says. Without any changes, it will be insolvent within seven years, Medicare trustees say. "You can't solve the problem in any permanent sense without reducing the rate of health-care growth," Rivlin says. "That is the central issue."

She says her parallel effort will also suggest cuts to Social Security. Spending for the program is projected to rise to about 6.1 percent of GDP by 2035, when nearly all baby boomers will have retired, from about 4.8 percent this year. Rivlin declined to offer specifics while saying there is a "finite" list of options, including increasing the early retirement age, currently 62. In a July 21 Brookings Institution article, Rivlin also argued for benefit reductions for high earners, along with raising the limit on earnings subject to the payroll tax, now at $106,800. One oft-cited plan by Robert C. Pozen, chairman emeritus of MFS Investment Management, would base initial benefits on prices rather than wages, and could solve half the problem since wages historically rise faster than prices.

The President's panel may just recommend what to do with the Bush-era tax cuts, says Ross K. Baker, a congressional expert at Rutgers University. "It's a time-honored tradition when you've got an intractable problem to hand it over to a commission," he says. Getting anyone to listen to her group will be a tall order, Rivlin admits. Yet this independent voice could provide political cover for unpopular solutions. "The cover of outside experts is important," says Chuck Blahous, a former economic aide to President George W. Bush and a public trustee for Social Security and Medicare. "Otherwise you just wind up replicating the partisan divide in Congress." The shadow group sees its work as an example for Obama's commission, Rivlin says. "We think it'll be useful; we think it'll get attention." —*Heidi Przybyla*

The bottom line *Budget hawks are formulating a deficit-cutting grand plan, the likes of which the Obama commission has been unable to produce.*

Poll Stat N°1

64

percent of likely voters say the nation is headed in the wrong direction

PHOTOS FROM LEFT: BRYAN SMITH/ZUMA PRESS; JOSE LUIS MAGANA/AP PHOTO. BECK/STEWART DATA: THE OCT. 7-10 POLL, CONDUCTED BY SELZER & CO., HAS AN ERROR MARGIN OF PLUS OR MINUS 3.1 PERCENTAGE POINTS.

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Politics&Policy

An exotic journey for Google revenues page 43 ▶



Free Speech

Mortal Kombat at the Supreme Court

▶ The video game industry doesn't want violent content regulated

▶ "This case is the hottest ticket in town right now"

George Rose hopes to have a front row seat in the nation's capital on Election Day. The executive vice-president of **Activision Blizzard**, the world's largest independent game developer, doesn't have politics on his mind. He'll be watching the Supreme Court oral argument on Nov. 2 in a case that could cost his company billions.

The high court, in *Schwarzenegger v. Entertainment Merchants Association and Entertainment Software Association*, is weighing whether a 2005 California law banning the sale of violent video games to minors violates the First Amendment right to free speech. (The law has never been enforced due to legal challenges.) If the high court upholds the California ban, video game companies would be required to attach a 2-inch by 2-inch white label marked "18" on the front of a boxed game deemed too violent for minors. Retailers that violate the ban would be subject to fines of $1,000.

Rose, Activision's chief public policy officer, and other critics argue that retailers and the video game industry already have voluntary restrictions on the sale of violent games to young consumers. Any new law, they say, would be unenforceable since video gamers increasingly buy games online or through mobile devices. "I'm not going to sit here and say protecting kids is a bad thing, but the way they're approaching it is not a smart thing to do," says Rose. "This case is the hottest ticket in town right now."

At issue is whether to extend a 1968 ruling in *Ginsberg v. New York*, in which the Supreme Court said the First Amendment doesn't protect the right to sell sexually explicit materials to minors. If the court applies that legal interpretation to violent video game content by upholding the California law, the implications for the $10.5 billion U.S. video game industry–and a number of others–could be considerable.

Industry tracker **NPD Group** says 24 percent of U.S. video game sales this year, or $2.5 billion worth, were considered violent enough to carry a voluntary M, for mature, rating, up from 17 percent last year. Business groups argue that upholding the California law could lead to restrictions on violent content in books, movies, even newspapers. Publishers, entertainment media, civil rights organizations, retailers, and 10 state attorneys general have lined up against the law.

Eleven other state attorneys general have filed briefs in support of the law, joining pundits like Eagle Forum President Phyllis Schlafly. "The video game industry is trying to wrap its evil products in the First Amendment," the conservative columnist wrote on Sept. 10 in an online column. California State Senator Leland Yee, the child psychologist who sponsored the law, argues that video games like Grand Theft Auto: Vice City; Postal 2; Duke Nukem Forever; and Activision's billion-dollar Call of Duty series glorify death and dismemberment.

In Postal 2, which is banned in Australia and several other countries, players can direct an animated character to urinate on a dead body, triggering the comment, "Now the flowers will grow." Yee says interactive games influence children more than any other medium. "You chop someone's head off, you set someone on fire, you're pulling a trigger again and again," he says.

The 9th Circuit Court of Appeals last year ruled that even violent video games deserve free-speech protections. When the Supreme Court peeled back the First Amendment protections in its 1968 ruling, the opinion said, it limited its actions only to obscenity, and even then only to sexual content. Federal and state courts have struck down laws similar to California's that would regulate violent games in eight other states.

The companies in 1994 established an independent rating agency, the Entertainment Software Rating Board (ESRB), with six categories. Buyers must be 18 years old to buy games rated M. They often include the most extreme examples of sexual content, violence, language, and alcohol and tobacco use. When an M game is scanned at **Best Buy**, **Wal-Mart**, and other retailers in the ESRB Retail Council, a register alert is supposed to trigger an ID check.

The California law's sponsors complain that the pledges are voluntary and not enforceable. They propose an accompanying state law that the industry is also fighting that would require retailers to segregate M-rated games from other games intended for children, and also require retailers to display signs explaining the rating system.

Video game developers argue that even if the Supreme Court reverses lower court rulings, there's no way to stop minors from playing violent video games. "Selling this stuff to children is not something we want to do. It's bad business," Rose says. "The way to approach this is through education and parental involvement, not laws."
—*Cliff Edwards*

The bottom line *The Supreme Court is weighing whether to uphold a California law banning sales of violent video games to minors.*

Poll Stat Nº 2

If the elections were held today, which party's congressional candidate would you vote for or are leaning toward?

42 percent said the Democrat

40 percent said the Republican

Campaign Finance

The Many Ties That Bind GOP Fundraisers

▶ A Republican network operates behind a web of new groups

▶ "Karl Rove figured out a neat trick ... his friends are eager to emulate"

A network of Republican-leaning groups is doing what the Grand Old Party and most of its candidates could not: outspend Democrats in the 2010 elections. Fueled by unlimited and often undisclosed donations from corpo-

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Races to Watch on Election Night

STATE

Indiana 6:00

WHO'S RUNNING:

Rep. Baron Hill *(D, incumbent)*
v.
Todd Young *(R)*

THE ISSUES:

- Hill's vote for health reform
- Cap-and-trade legislation
- Young's reference to Social Security as a Ponzi scheme

WHO'S AHEAD:



THE STORY:

How big a GOP tidal wave?

When Democrat Baron Hill won his U.S. House race in 2006, he retook the Indiana seat from the Republican who had ousted him two years earlier. Hill's return signaled a national wave that put his party in control of Congress. This year, Republicans hope to once again bounce Hill from office in this swing district in the state's southeast corner. With polls closing at 6 p.m. EDT, the outcome may provide an early glimpse of what's in store nationwide. Hill faces a new Republican challenger, local prosecutor Todd Young. A Hill loss could indicate "a really bad night for the Democrats," says Brian Vargus, a political scientist at Indiana University-Purdue University Indianapolis. The district—which includes Bloomington, home of Indiana University, and which Obama lost to John McCain by 1 percentage point in 2008—"is the type Republicans should win in a wave," says Nathan Gonzales of the nonpartisan *Rothenberg Political Report*. —*Catherine Dodge*

Virginia 7:00

WHO'S RUNNING:

Rep. Tom Perriello *(D, incumbent)*
v.
Robert Hurt *(R)*

THE ISSUES:

- Health reform
- Stimulus measure
- Cap on carbon emissions

WHO'S AHEAD:



THE STORY:

Will low turnout by blacks and younger voters be key?

Buoyed by college students and blacks energized by Barack Obama's Presidential bid, Democrat Tom Perriello two years ago won a U.S. House seat in Virginia by 727 votes—in percentage terms, the nation's closest congressional contest. This year, his race against Republican Robert Hurt, a state senator, tests whether Democrats can survive without Obama on the ticket and with unpopular votes on their records. In the largely rural district that includes the University of Virginia, about 20 percent of 2008's voters were African American, and the college yielded 4,000 new Democratic backers. Many of those have graduated, while newcomer students don't seem as motivated. "Perriello would be lucky to get a third" as many to the polls, says David Wasserman of the nonpartisan *Cook Political Report*. Perriello raked in $3.1 million by Oct. 15 to Hurt's $1.7 million. Still, polls show him lagging Hurt, who excoriates government's growth. —*Laura Litvan*

West Virginia 7:30

WHO'S RUNNING:

John Raese *(R)*
v.
Joe Manchin *(D)*

THE ISSUES:

- Health reform
- Legislation to cap carbon emissions
- President Obama

WHO'S AHEAD:



THE STORY:

Could Democrats lose control of the Senate?

Democrat Joe Manchin is the popular West Virginia governor vying for the Senate seat opened up by Robert Byrd's death in June. But an Oct. 12 survey by Public Policy Polling shows 47 percent of voters would prefer Manchin, who won reelection with 70 percent of the vote in 2008, remain as governor. Another issue is Obama's unpopularity in the state; he lost it in 2008 by 13 percentage points. The upshot may be a crucial Republican win that helps the GOP gain the 10 seats it needs for Senate control. Republican businessman John Raese has transformed the contest into a toss-up by urging West Virginians to do their part to put a check on Obama. To counter that argument, Manchin in one ad dons a hunter's outfit and, toting a shotgun, promises to "get the federal government off our backs." The ad ends with Manchin shooting a bullet through climate-change legislation—disliked in the coal-rich state—that's nailed to a tree. —*James Rowley*

Ohio 7:30

WHO'S RUNNING:

Rep. Mary Jo Kilroy *(D, incumbent)*
v.
Steve Stivers *(R)*

THE ISSUES:

- Financial regulation reform
- Health-care overhaul
- Stimulus spending

WHO'S AHEAD:



THE STORY:

How tough will Obama's 2012 reelection be?

President Obama was back in Columbus, Ohio, on Oct. 17 for a get-out-the-vote rally on the Ohio State University campus. It was his 11th trip to the state since taking office—and his fourth to Columbus. One of the beneficiaries of these visits is U.S. Representative Mary Jo Kilroy, a first-time Democrat battling for another term. But Obama himself has plenty to gain from reminding Ohio voters why they backed him in 2008. He won Kilroy's district by 9 percentage points, while she eked out a 2,311-vote win. Polls show Kilroy trailing this year after supporting Obama's health-care bill, the stimulus, and new rules for the nation's financial markets. Some Obama voters are revisiting their support for the President and his party. "I just think we need a change," says Gordon Reis, a resident of Worthington, Ohio, who plans to vote for just one Democrat this year—for county commissioner—after voting for Obama and Kilroy in 2008. —*Patrick O'Connor*



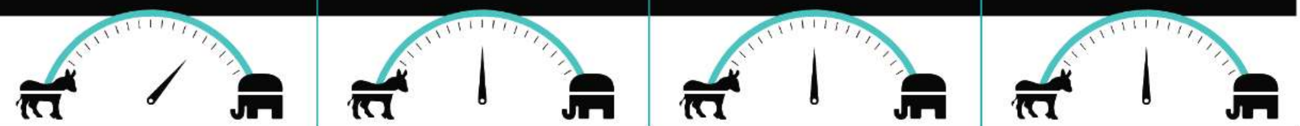
REUTERS (2); GETTY IMAGES (5); NEWSCOM (2); REDUX (2); ZUMA PRESS (2); BLOOMBERG (2)

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"It may cost me an election."
—Representative Chet Edwards (D-Tex.), speaking of his vote for President Obama's stimulus measure

"Man up, Harry Reid. You need to understand that we have a problem with Social Security."
—Sharron Angle, debating the Senate Majority Leader on Oct. 14



Texas
8:00

Rep. Chet Edwards *(D, incumbent)*
v.
Bill Flores *(R)*

- Bank bailouts
- Stimulus spending
- Increase in government debt

Is economic populism a winning formula?
There's no shortage of Democratic candidates under fire for having cast unpopular votes in the last two years. One bellwether is Texas Democrat Chet Edwards, a 10-term incumbent who has hung onto his heavily Republican district, wedged between Dallas and Austin, by rejecting some of his party's biggest priorities. This term, he opposed Obama's health-care overhaul. But he gave Republican challenger Bill Flores an opening with votes for the Troubled Asset Relief Program and the equally unpopular stimulus plan, which the lawmaker admits might finally do him in. "It may cost me an election," Edwards told the *Dallas Morning News*. "But it was the right thing to do." Analysts give Flores the edge, even though most GOP leaders in Congress voted for TARP, too. News that the much-maligned bank bailout will cost about $50 billion, a fraction of what was initially feared, may be too late for Edwards. Voters so despise TARP, lawmakers say, it's not worth trying to change minds. —*Brian Faler*

Colorado
9:00

Sen. Michael Bennet *(D, incumbent)*
v.
Ken Buck *(R)*

- Jobs
- The economy
- Government spending

How influential will money from outside groups be?
Colorado may be Karl Rove's next proving ground. Independent groups, two of which the Republican super-strategist helped start, are pouring money into the state. Between Sept. 1 and Oct. 17, outside groups reported spending $13.6 million here, more than in any other state, with $8.5 million helping Republican candidates. "You can't have your television on for 10 or 15 minutes without seeing at least two or three ads saying that someone shouldn't have been born," says Kenneth Bickers, chairman of the University of Colorado at Boulder's political science department. The Rove groups, American Crossroads and Crossroads GPS, have raised $56 million and spent $3.7 million through Oct. 17 to oppose Democratic Senator Michael Bennet, who is in a tight race with Republican Ken Buck, a Tea Party favorite. Colorado also has three House Democrats–Ed Perlmutter, John Salazar, and Betsy Markey–with close contests, making them vulnerable to attacks. The outside money may tilt the balance. —*Kristin Jensen, Jonathan D. Salant, and Traci McMillan*

Nevada
10:00

Sen. Harry Reid *(D, incumbent)*
v.
Sharron Angle *(R)*

- Nevada's 14.4 percent jobless rate, the highest in the nation
- Home foreclosure rates
- Immigration

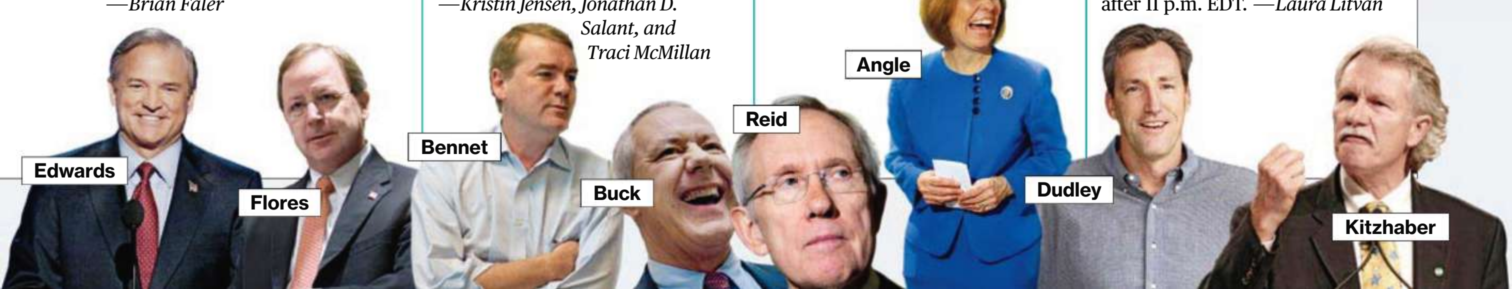
Can the Tea Party's long-shot candidates win?
Even the Vegas oddsmakers can't pick this one. Polls show the contest between Majority Leader Harry Reid and Sharron Angle, a Tea Party darling, for the Senate is one of the closest in the nation. It may well be the most important, too. The race has become a proxy for whether Tea Party insurgents can elect long-shot candidates, as well as defeat one of the leaders of the party in power. The Democratic Establishment has rallied around Reid, with President Obama set to make his third appearance in the state on Oct. 22. Reid needs all the help he can get–Angle raised more than $14 million in the third quarter to his $2.8 million. Much of the spending has gone toward attack ads that have made even some in Sin City blush. When the candidates faced off in an Oct. 14 debate, Reid repeatedly called Angle extreme, while Angle called on Reid to "man up" in dealing with a looming Social Security crisis. —*John McCormick*

Oregon
mostly mail-in

Chris Dudley *(R)*
v.
John Kitzhaber *(D)*

- High jobless rate
- Education reform
- Government expansion

Will Republicans gain eight governors?
The anti-Establishment mood prevalent in much of the U.S. is bolstering the prospects of Republican Chris Dudley in Oregon's gubernatorial race, as the political newcomer seeks to break the state's streak of six straight Democratic chief executives. If Dudley prevails, he would be part of a net gain in Republican governors that some analysts say could go as high as eight, for a total of 32. That would be the most since 1998 and would put the party in enviable shape as states prepare to redraw their political boundaries. Dudley, a former center on the Portland Trail Blazers basketball team, is in a tight race with Democrat John Kitzhaber to replace retiring Governor Ted Kulongoski. Kitzhaber, governor from 1995 to 2003, argues his experience will benefit a state with 10.6 percent unemployment. Dudley, a towering figure at 6-foot-11, says his lack of a political pedigree is an asset. Oregon's balloting is mail-in, or hand-in by 8 p.m. local time on Nov. 2. Results are announced on Election Day after 11 p.m. EDT. —*Laura Litvan*



Politics&Policy

Rove's World

- Rove Linked
- Common Media Buyer
- GOP Operatives

American Crossroads
Spent $12.4 million

Crossroads Media of Alexandria

Crossroads GPS
Spent $7.9 million

Michael Dubke
co-founded Black Rock Group with Carl Forti
founder of Crossroads Media

Americans for Job Security
Spent $4.5 million

Jo Ann Davidson
a director of American Crossroads
former chair of the 2008 Republican National Convention



Karl Rove

Maria Cino
on the board of American Action Network
lobbyist for Pfizer
former president of the 2008 Republican National Convention

American Action Network
Spent $10.5 million

60 Plus Association
Spent $6.3 million

Carl Forti
political director, American Crossroads
handles publicity for 60 Plus
former communications director for NRCC
co-founded Black Rock Group with Michael Dubke

Norm Coleman
heads American Action Network
former Minnesota Senator

Tom Reynolds
on the board of American Action Network
former New York Representative
former chair of the NRCC

rations and wealthy individuals, these organizations, with names like American Crossroads and the American Action Network, have spent $98 million between Sept. 1 and Oct. 17 on House and Senate races. That's more than three times as much as Democrat-friendly organizations.

Many of these campaign fundraisers are prominent figures from President George W. Bush's Administration, such as White House aides Karl Rove and Ed Gillespie. The groups share a political agenda, personnel, and even office space. "It's almost as if these are shadow parties," says Bill Allison, editorial director for the Sunlight Foundation, a Washington watchdog group. They've found a way to supplement the official Republican campaign committees, Allison says, "without having to play by the same rules."

The Rove operation is the biggest of the newly formed Republican super PACs, so-called because they can accept unlimited donations from corporations and individuals, though as political action committees these outfits must disclose donor names and amounts to the Federal Election Commission. Two companies led by Harold C. Simmons, chairman of Dallas-based Titanium Metals, gave $1 million each to American Crossroads, FEC filings show.

Other groups, such as Americans for Job Security and Crossroads GPS, an affiliate of Rove's American Crossroads, are incorporated under section 501(c) of the tax code. That designation gives them the freedom to run television ads without saying who's really paying.

Poll Stat Nº 3

43 percent of likely voters think Congress should extend the Bush tax cuts for the middle class—and not for the highest earners

34 percent favor extending the cuts for all income levels

President Barack Obama has attacked the outside spending because voters can't discern the agenda of those bankrolling the ads. While the 501(c) groups must report spending on some political ads to the FEC, Senate Republicans blocked legislation requiring the organizations to disclose their donors. "Karl Rove figured out a neat trick, and his friends are eager to emulate it," says Lisa Gilbert, deputy director of Public Citizen's Congress Watch, which favors more donor disclosure. Rove declined to comment.

Some of these Republican-supporting groups are closely connected (left). One pivotal member is Carl Forti, the political director for Rove's American Crossroads who also handles publicity for the 60 Plus Assn., a group that supports privatizing Social Security and has spent $6.3 million on ads favoring Republicans from Sept. 1 through Oct. 17. Another is former Representative Thomas M. Reynolds of New York, who chaired the National Republican Congressional Committee when Forti worked there earlier in the decade and sits on the board of American Action Network (AAN), headed by former Republican Senator Norm Coleman of Minnesota. That group has spent $10.5 million in the same period.

Now things really get intertwined: Forti co-founded the consulting firm Black Rock Group with Michael Dubke, who once led Americans for Job Security, a group that wants to retain all of the Bush-era tax cuts and has spent $4.5 million. Dubke in turn is the founder of Crossroads Media of Alexandria, Va., which has handled advertising for American Crossroads, AAN, and Americans for Job Security. The American Crossroads strategists lease space from Coleman's AAN and meet there with other Republican-leaning groups, says Jonathan Collegio, a spokesman. The organizations are "making sure that our ad buys don't step on an ad buy of another group," he says. There is no shortage of contributors to finance those ad buys, Forti says. "Donors are energized because of the opportunity that exists right now," he says. "Voters are angry."

—Jonathan D. Salant and Kristin Jensen with Traci McMillan

The bottom line *Numerous connections tie together groups raising and spending big money in support of Republican candidates.*

PHOTO: FILMMAGIC/GETTY IMAGES.
POLL DATA: BLOOMBERG NATIONAL POLL OF 721 LIKELY VOTERS, CONDUCTED OCT. 7-10; MARGIN OF ERROR IS PLUS OR MINUS 3.7 PERCENTAGE POINTS.

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Charlie Rose talks to

Robert Reich



The Berkeley professor and Clinton Labor Secretary on the beleaguered American middle class and President Obama's mixed-up messaging

As we emerge from this economic crisis, how are we doing? And what is making this recovery so difficult?
Consumers are 70 percent of the economy, and they have to come out from under a massive debt load. They're worried about their savings. They can't use their homes as ATM machines. They can't send any more people into work. You know, in the '70s and '80s, women marched into the paid workforce. They can't work longer hours if they have jobs, because many people are already holding down two or three jobs if they have work. We have almost come to the end of the "coping mechanisms," as I call them.

Why did they lose their purchasing power? And why is it so difficult to fix?
We know that globalization and technological change undermined routine jobs. Either the work was sent abroad because cargo ships, container ships, satellite communication technologies, and eventually the Internet allowed the production process to be parceled out around the globe to wherever it could be done most cheaply, or it was automated here at home. And that means that the two categories of job that are left are, No. 1, high-skilled, well-educated, well-connected people, a lot of them in financial-related jobs, or a larger and larger number of jobs in the local service economy: retail, restaurant, hotel, hospital, and so on.

What steps could have been taken to maintain a manufacturing base?
There were policy moments when the U.S. government could have and should have invested more in education, in job training, in early childhood education, in free public higher education, in research and development, in infrastructure. I mean, the entire infrastructure of the country is crumbling. This is not an ideological proposition. Everybody knows this.

The argument has been made that the TARP money was repaid, that General Motors is back on its feet. So the steps that were taken to prevent a total collapse of the economy succeeded.
Main Street–the homeowners, small businesses–did not get bailed out. They are still in deep, deep trouble. Most Americans don't feel that this recession is over. A lot of people say, even if the TARP money is repaid, "I should get bailed out as well. I can eventually repay whatever is given to me. I can eventually do better. I mean, a business cycle is still a business cycle. But nothing came my way. Nothing trickled down."

You make the argument that Henry Ford in a sense paid his workers well because he wanted them to buy his cars. What's the equivalent of that today?
Henry Ford, by the way, was accused by *The Wall Street Journal* of being an economic criminal. Many people called him a socialist because he paid his workers $5 a day, which was three times the normal wage. And he said, "Look, I'm a smart businessman, because they are also consumers." And he was right. I call that the basic bargain. Between 1947 and 1975, when the economy expanded much faster than it has been expanding over the last 30 years, everybody gained. The bottom 20 percent did even better than the top 20 percent. Partly because 30 percent of Americans were unionized, partly because we had a high marginal income tax on high earners, partly because we as a country invested substantially in education and infrastructure. We committed ourselves during those 30 years to broad widespread prosperity of the sort we have not had since.

Do you think Obama's economic and political philosophy is significantly different from Bill Clinton's?
No, I don't.

Then how has Obama ended up with this reputation as a European social democrat or worse, in terms of perception by the right and by some in the business community?
It's a good question, because the Obama Administration has been as kind, if not kinder, to business and Wall Street as any previous Administration I can remember. I mean, the Wall Street bailout itself should have convinced the business community and Wall Street that Obama and his Administration were very probusiness.

He had a campaign narrative, but never had a narrative of governing that connected the dots.
It's a real irony, because you have a President who came into office as one of the best explainers in history. But he seems to have got caught up in Washington's instinct for the capillary. You know, the tactical judgments that Washington gets worried about rather than the large, strategic narrative. Ⓑ



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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Contents ▶ **The digital do-gooders at Causes** 45 ▶ **Kleiner Perkins' new $250 million fund** 46 ▶ **Tablet Mania: What's now, what's next** 46 ▶ **Innovator: Adobe researcher Todor Georgiev is focused on plenoptic lenses** 48 ● **Edited by Barrett Sheridan**

Technology

Google has made $11.1 billion overseas since 2007. It paid just 2.4% in taxes. And that's legal.



Google co-founders Larry Page and Sergey Brin





Google's overseas tax provision, as a percentage of earnings

... or at least it is after the cash travels through three territories

▶ Google uses a complicated structure to send most of its overseas profits to tax havens

▶ "The system is broken and ... companies are getting away with murder"

The heart of **Google**'s international operations is a silvery glass office building in central Dublin, a block from the city's Grand Canal. In 2009 the office, which houses roughly 2,000 Google employees, was credited with 88 percent of the search juggernaut's $12.5 billion in sales outside the U.S. Most of the profits, however, went to the tax haven of Bermuda.

To reduce its overseas tax bill, Google uses a complicated legal structure that has saved it $3.1 billion since 2007 and boosted last year's overall earnings by 26 percent. While many multinationals use similar structures, Google has managed to lower its overseas tax rate more than its peers in the technology sector. Its rate since 2007 has been 2.4 percent. According to company disclosures, **Apple**, **Oracle**, **Microsoft**, and **IBM**—which together with Google make up the top five technology companies by market capitalization—reported tax rates between 4.5 percent and 25.8 percent on their overseas earnings from 2007 to 2009. "It's remarkable that Google's effective rate is that low," says Martin A. Sullivan, a tax economist who formerly worked for the U.S. Treasury Dept. "This company operates throughout the world mostly in high-tax countries where the average corporate rate is well over 20 percent." The corporate tax rate in the U.K., Google's second-largest market after the U.S., is 28 percent.

In Bermuda there's no corporate income tax at all. Google's profits travel to the island's white sands via a convoluted route known to tax lawyers as the "Double Irish" and the "Dutch Sandwich." In Google's case, it generally works like this: When a company in Europe, the Middle East, or Africa purchases a search ad through Google, it sends the money to Google Ireland. The Irish government taxes corporate profits at 12.5 percent, but Google mostly escapes that tax because its earnings don't stay in the Dublin office, which reported a pretax profit of less than 1 percent of revenues in 2008.

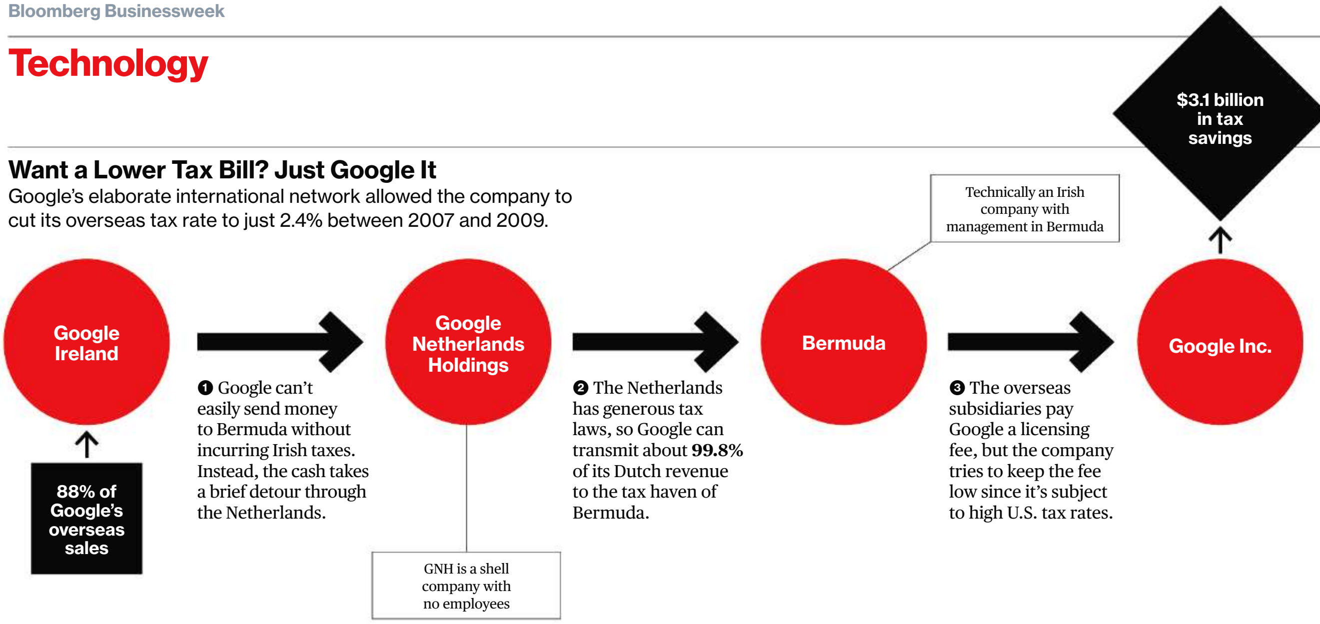
Irish law makes it difficult for Google to send the money directly to Bermuda without incurring a large tax hit, so the payment makes a brief detour through the Netherlands, since Ireland doesn't tax certain payments to companies in other European Union states. Once the money is in the Netherlands, Google can take advantage of generous Dutch tax laws. Its subsidiary there, Google Netherlands Holdings, is just a shell

CLOCKWISE FROM LEFT: LEE FOSTER/LONELY PLANET IMAGES; STUART RAMSON/POLARIS; PAUL MCERLANE/BLOOMBERG

Technology

Want a Lower Tax Bill? Just Google It

Google's elaborate international network allowed the company to cut its overseas tax rate to just 2.4% between 2007 and 2009.



(it has no employees) and passes on about 99.8 percent of what it collects to Bermuda. (The subsidiary managed in Bermuda is technically an Irish company, hence the "Double Irish" nickname.)

All of these arrangements are legal. "Google's practices are very similar to those at countless other global companies operating across a wide range of industries," says Jane Penner, a company spokeswoman who declined to address the particulars of Google's tax strategies. Irving H. Plotkin, a senior managing director at PricewaterhouseCoopers' national tax practice in Boston, says that "a company's obligation to its shareholders is to try to minimize its taxes and all costs, but to do so legally."

The setup lowers Google's overseas tax bill, but it also affects U.S. tax revenues as the government struggles to close a projected $1.4 trillion budget gap. Google Ireland licenses its search and advertising technology from Google headquarters in Mountain View, Calif. The licensing agreement allows Google to attribute its overseas profits to its Irish operations instead of the U.S., where most of the technology was developed. The subsidiary is supposed to pay an "arm's length" price for the rights, or the same amount an unrelated company would. Yet because licensing fees from the Irish subsidiary generate income that is taxed at 35 percent, one of the highest corporate rates in the world, Google has an incentive to set the licensing price as low as possible. The effect is to shift some of its profits overseas in an arrangement known as "transfer pricing."

This, too, is legal. In 2006 the IRS approved Google's transfer pricing arrangements, which began in 2003, according to Google's SEC disclosures.

Transfer pricing arrangements are popular with technology and pharmaceutical companies in particular because they rely on intellectual property, which is easily transportable across borders. **Facebook** is preparing a structure similar to Google's that will send earnings from Ireland to the Cayman Islands, according to company filings and a person familiar with the arrangement. Microsoft and **Forest Laboratories**, maker of the blockbuster antidepressant Lexapro, have used a similar Irish-Bermuda transfer pricing arrangement. Facebook, Forest, and Microsoft declined to comment.

Even if the tax avoidance structures are legal, not everyone considers them ethical. Google is "flying a banner of doing no evil, and then they're perpetrating evil under our noses," says Abraham J. Briloff, a professor emeritus of accounting at Baruch College who has examined Google's tax disclosures. "Who is it that paid for the underlying concept on which they built these billions of dollars of revenues? It was paid for by the United States citizenry," Briloff says, referring to the fact that Google's initial technology was based in part on research done at Stanford University and funded by the National Science Foundation. Profit shifting arrangements such as Google's cost the U.S. government as much as $60 billion in annual revenue, according to Kimberly A. Clausing, an economics professor at Reed College in Portland, Ore.

The government has made halting steps to change the rules that let multinationals shift income overseas. In 2009 the Treasury Dept. proposed levying taxes on certain payments between U.S. companies' foreign subsidiaries, potentially including Google's transfers from Ireland to Bermuda. The idea was dropped after Congress and Treasury officials were lobbied by companies including **General Electric**, **Hewlett-Packard**, and **Starbucks**, according to federal disclosures compiled by the nonprofit Center for Responsive Politics. In February the Obama Administration proposed measures to curb companies' ability to shift profits offshore, but they've largely stalled.

"The system is broken, and I think it needs to be scrapped," says Reuven S. Avi-Yonah, director of the international tax program at the University of Michigan Law School. "Companies are getting away with murder." —*Jesse Drucker*

The bottom line *Google has built a complicated international structure that sends most of its overseas profits to the tax haven of Bermuda.*

Quoted

"He was trying to fill some pretty big shoes—you don't just walk in and become the next Bill Gates."
—Gartner analyst David Smith on Ray Ozzie (right), Microsoft's chief software architect, who announced his resignation on Oct. 18



CLOCKWISE FROM BOTTOM RIGHT: PHOTOGRAPH BY ROBYN TWOMEY FOR BLOOMBERG BUSINESSWEEK; KEVIN P. CASEY/AP; US AIRFORCE/ZUMA PRESS

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Will a GOP win clip defense stocks? page 53 ▶

Social Networks

Sharing—and Giving—On the Web

▶ For-profit startup Causes uses Facebook to encourage giving

▶ "I view these guys as the modern social revolutionaries"

On an October visit to Taiji, Japan, Leilani Münter captured the killing of 15 dolphins on video. The professional race car driver, who lives in North Carolina, uploaded the clip to **Causes**, a website that's become the online hub for Save Japan Dolphins. The video got more than 10,000 views in three days and inspired people around the world to contact Japanese embassies in their hometowns to complain.

Founded in 2007 by political activist Joe Green and former **Facebook** President Sean Parker (yes, *that* Sean Parker), Causes uses social media tools to virtually connect thousands of charities with their supporters and potential donors. The Berkeley (Calif.) company began as one of the first applications on Facebook and now serves as a broker for 119 million charitably minded users. On Oct. 18, Causes announced a $9 million round of venture capital investment that will allow it to add more software engineers to its 16-person workforce. "I view these guys as the modern social revolutionaries," says Marc Benioff, chief executive officer of **Storemags.com**, who invested in the latest round of financing. "If they were born in the '60s, they would be protesting the war. Instead they're trying to change the world through the Internet."

Not just the Internet. Causes is about to enter the offline retail market with $25 and $50 gift cards. The cards, which allow giftees to donate to their choice among thousands of Causes-affiliated charities, will be available in all California **Safeway** and **Vons** supermarkets by yearend. Causes won't make money off the cards, but hopes they help build awareness of the brand outside of Facebook, says Parker. "This could be a successful gift card, and a successful gift card usually does a half-billion dollars" in total annual payment volume, Parker says. That's an ambitious goal: Causes says it currently facilitates about $1 million a month in donations.

The aim of the startup is to encourage more charitable giving through digital means. "Charity is this huge opportunity because it is large and it's a system that has a lot of problems," says Green, 27. Bill Drayton, founder of Ashoka, which advises socially minded entrepreneurs, says the financing system for nonprofits is "one of the biggest bottlenecks holding back change in the world." Causes, says Drayton, is "part of a wave of experimentation" trying to make giving more efficient.

Americans donate $263 billion a year to charities, but only 5.7 percent of that is given online, according to the Blackbaud Index of Online Giving, which tracks fundraising. Many charities still rely on expensive, inefficient direct-mail and telemarketing campaigns to spread their message and solicit donations. Ettore Rossetti, director of Internet marketing for Save the Children, adds that most current donors are middle-aged or elderly. He sees Causes as


Founder Joe Green, center, calls charity a "huge opportunity"

a way to reach the next generation. "We better be in sync with the tools they use to communicate," he says.

Parker, 31, says Facebook and other online networks are much better than offline methods for "leveraging social capital between people to get things done in the world." One of Causes' most successful services, for example, is its birthday application. Through it, Causes has raised more than $7.6 million by encouraging users to ask for charitable donations instead of gifts on their birthdays.

The nonprofit-focused Causes is a for-profit company and asks users for a voluntary "tip" of 10 percent or more on their donations. It also partners with corporations, which pay between $50,000 and $300,000 for sponsored fundraising campaigns. Causes says it's operating at break even. "For a company like this to be of enduring value, it's best served being a for-profit company," says Scott Sandell, a general partner at venture capital firm **NEA**, which invested in Causes' latest round of funding. "The profit motive will make it the most efficient possible organization." *—Douglas MacMillan*

The bottom line *Fresh off a new round of investment, Causes hopes to reach more potential donors by selling charitable gift cards in supermarkets.*

Venture Capital

John Doerr Makes A Social Call



- The Silicon Valley legend returns to the consumer Internet with sFund
- These guys "think they can goose [social] to a whole new level"

John Doerr nearly relinquished his crown. The famed king of Silicon Valley's venture capital community led early investments in Netscape, Amazon.com, and Google, building a global reputation as the oracle of the consumer Internet. Over the last decade, however, Doerr and his firm took a detour into clean technology, loudly warning about the risks of climate change while making huge bets on renewable energy companies. Although **Kleiner Perkins Caufield & Byers** backed hot social gaming company **Zynga** and started the $200 million **iFund** for iPhone developers in late 2008, rival VC firms found **Facebook** and **Twitter**, which are quickly becoming the new dominant players on the Valley scene.

Now Doerr is back to fund the next round of consumer Web startups, and perhaps reclaim his legacy. As of press time on Oct. 20, he was scheduled to appear at the offices of Facebook in Palo Alto, Calif., on Oct. 21 to unveil a new $250 million investment fund, called the **sFund**, aimed at backing the kinds of hot social startups that connect people online to their friends in new ways.

Although Kleiner will provide much of the $250 million, **Amazon**, Facebook, and Zynga are also anchor investors in the fund and promise to work with the entrepreneurs that Kleiner backs, in the same way **Apple** provides special access to the developers who receive money from the iFund. Jeff Bezos, Mark Zuckerberg, and Zynga CEO Mark Pincus were expected to join Doerr at the event. **Comcast** and the investment bank **Allen & Co.** will also invest.

Consumer Electronics

Tablet Mania: What's Now and What's Next

While Apple has taken an early lead with its iPad, at least a dozen rivals are betting they can build a better tablet. They're experimenting with different screen sizes, embracing Google's Android operating system, and building up their cache of apps. Here's a look at some of the competition. —*Cliff Edwards*



1 Apple iPad

Operating System: iOS
9.7-in. screen, 1.5 lbs.
Battery life: 10 hours
Launch: Apr. 2010
Connectivity: Wi-Fi, 3G
Price: $499

Bonus: High-definition screen. Thousands of apps available.



2 Dell Streak

OS: Android
5-in. screen, 0.5 lbs.
Battery life: 10 hours
Launch: Aug. 2010
Connectivity: Wi-Fi, 3G
Price: $299

Bonus: Connects to cellular networks to make calls.



3 Archos 10.1

OS: Android
10.1-in. screen, 1 lb.
Battery life: 12 hours
Launch: Nov. 2010
Connectivity: Wi-Fi
Price: $299

Bonus: High-definition graphics.



4 Samsung Galaxy Tab

OS: Android
7-in. screen, 0.8 lbs.
Battery life: 7 hours
Launch: Nov. 2010
Connectivity: 3G
Price: $400

Bonus: Video calling; available through all carriers.



5 Toshiba Folio

OS: Android
10.1-in. screen, 1.7 lbs.
Battery life: less than 7 hours
Launch: Nov. 2010
Connectivity: Wi-Fi
Price: $550

Bonus: High-definition graphics.



6 RIM PlayBook

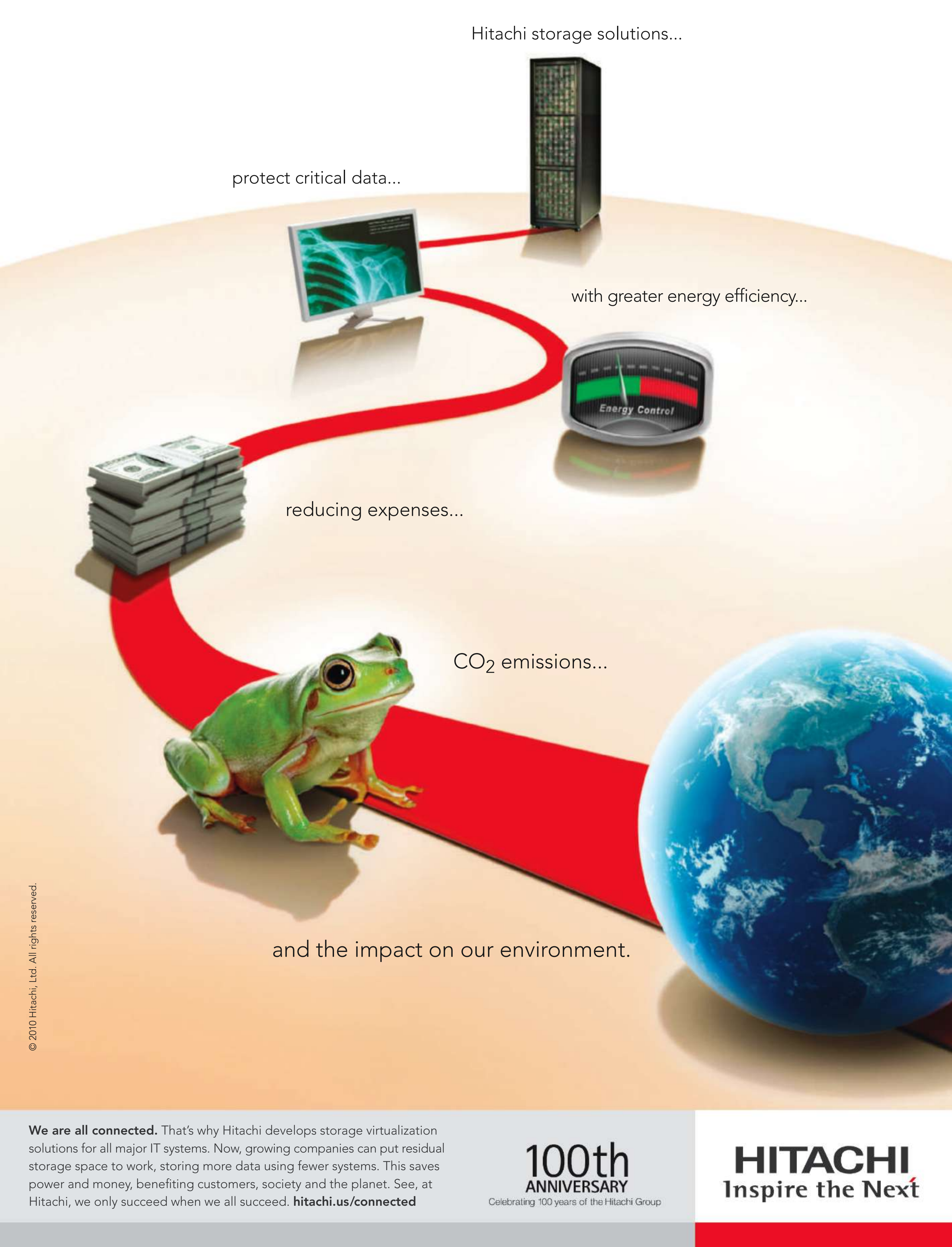
OS: BlackBerry tablet
7-in. screen, 0.9 lbs.
Battery life: N/A
Launch: Early 2011
Connectivity: Wi-Fi, 3G
Price: N/A

Bonus: Syncs with BlackBerry devices; corporate apps.

TOP: LYNN GOLDSMITH/CORBIS

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Innovator

Todor Georgiev



With a plenoptic lens and special software, the Adobe researcher can make a blurry photo look crisp even after the shutter's been clicked

The sun sinks to the horizon, the surf crashes, a pelican flies by, and–snap–you catch the perfect moment in a photo. It's only later that you realize it's completely out of focus.

Todor Georgiev's work at Adobe Systems may make such frustrations a thing of the past. As a senior research scientist with the company's Photoshop Group, Georgiev is experimenting with plenoptic lenses. His plenoptic lens is actually an array of thousands of micro-lenses carved into a silicon wafer. With one shutter click, it captures thousands of variations–different exposures or depths of field, for instance–of the same image.

The technology has been around for a few decades, but Georgiev is pushing it further. Working with Andrew Lumsdaine, a computer scientist at Indiana University, he has built specialized software to interpret plenoptic photos and enable after-the-fact alterations. In an online video demonstrating the technology, Georgiev projects a picture of a field with a young girl in the foreground and beehives off in the distance. By adjusting a few values on a computer, Georgiev brings the girl into focus. A few adjustments more, and the beehives become crisp while the girl's image blurs.

It's a stepping-stone on the way to Georgiev's goal of designing a camera that can "capture all available optical data" with a single click of the shutter. Though cameras have become digital, they're still limited by physical hardware, namely lenses, which are expensive and difficult to produce. Plenoptic lenses will eventually be manufactured using techniques similar to those used in the semiconductor industry, says Georgiev, and will benefit from economies of scale once the technology catches on. "Things that were mechanical become digital," says Georgiev. "The abacus became a calculator. It feels like optics are now becoming digital."

Georgiev was born and raised in Bulgaria and went on to study quantum physics at Southern Illinois University. Eventually he realized it was going to be tough to find a job in basic science, and he returned to school for a master's in computer science. As a software engineer at Adobe in the early 2000s, he helped develop Photoshop's "heal" tool, a utility for photographers who need to correct scratches, wrinkles, or other blemishes on their images. He then started tinkering with plenoptic lenses at home in his garage, and eventually persuaded Adobe to let him work on his hobby full-time.

Adobe may decide to license the technology to camera and lens manufacturers, says Kevin Connor, a vice-president for digital imaging, though profits aren't the primary motivation. He believes Adobe will benefit from Georgiev's research indirectly as his insights find their way into new software products. Including, perhaps, a tool that helps fix your not-so-perfect shot of the sunset. B

—*Barrett Sheridan*

Education ▶ Studied quantum physics before switching to computer science

Success ▶ Helped develop the popular "heal" tool in Adobe's Photoshop

Technology ▶ Plenoptic lenses capture thousands of variations of an image

Technology

"Social is obviously already big, but here is a group of people who think they can goose it to a whole new level," says Bing Gordon, a Kleiner Perkins partner and former executive at video game company Electronic Arts who will administer the sFund with help from Doerr and others at Kleiner Perkins. "The primary goal of the sFund is not to create the next Facebook. It's to support companies that make this new user behavior more productive."

Kleiner's return to the world of consumer Internet investing may be a hedge of sorts. Over the last decade, the firm has plunged hundreds of millions into renewable energy companies like **MiaSolé**, a thin-film solar panel startup, and **Bloom Energy,** a fuel cell firm. Those companies now look like anything but sure bets. They face uphill battles against heavily subsidized Chinese greentech firms, at the same time the price of oil has retreated from stratospheric highs.

Another cloud looming over Kleiner's cleantech position is California's Proposition 23, which would override a 2006 global warming law and suspend the state's emission reduction targets. The ballot measure, backed by Big Oil, could decimate some of Kleiner's energy startups. Doerr and his wife, Ann, have contributed some $2 million to fighting it, according to campaign finance records. "Kleiner is very long-term focused and they understand politics, so I wouldn't be surprised if [Prop. 23] played a part" in the creation of the sFund, says Mark G. Heesen, president of the National Venture Capital Assn. Heesen adds: "Folks like John Doerr understand social media is no longer a U.S. phenomenon. There is a huge potential market here."

Gordon disputes the notion that the sFund is a hedge, and says that green technology is still "one of the great macro investment categories of the decade, maybe of the century." He also says that with the sFund, Doerr is simply doing what he does best: connecting unlikely allies, like Mark Zuckerberg and Jeff Bezos, and aligning them behind a common goal. "John is the ultimate partnership builder," Gordon says. "If you want to think big, you want to have John Doerr in the room." —*Brad Stone*

The bottom line *As its cleantech investments struggle, Kleiner Perkins is starting a $250 million fund to invest in the social Web.*

PHOTOGRAPH BY TIMOTHY ARCHIBALD FOR BLOOMBERG BUSINESSWEEK

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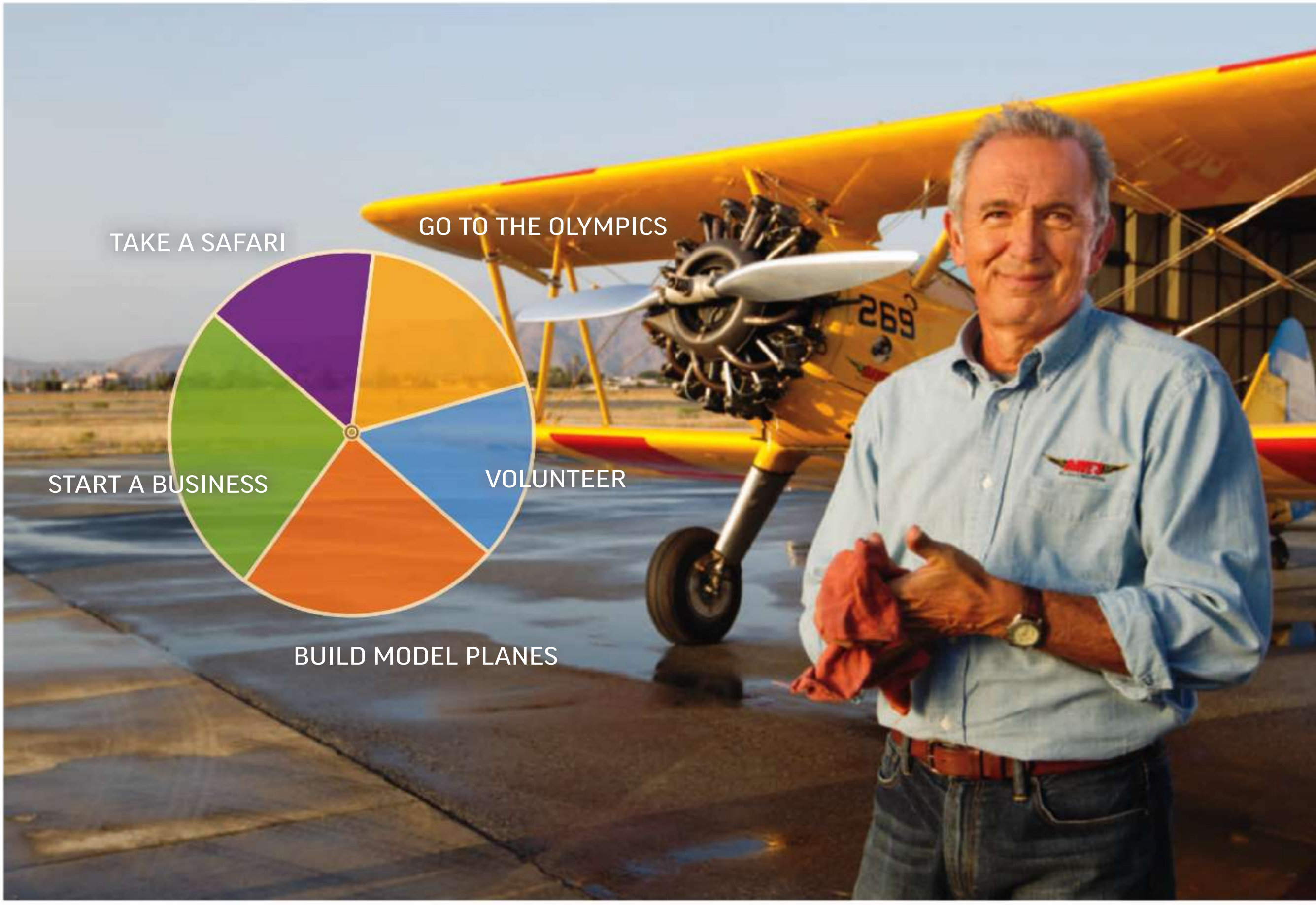
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Howard Lutnick's Outsized Ambition

▶ **The Cantor Fitzgerald chief is on a hiring binge and moving the firm in new directions**

▶ **"It's hard for bad things to happen when you have no debt"**



Lutnick prefers acting as a middleman to risking his firm's money trading

PHOTOGRAPH BY ANDREW HETHERINGTON FOR BLOOMBERG BUSINESSWEEK

The financial crisis has been good to **Cantor Fitzgerald** Chief Executive Officer Howard W. Lutnick. It crushed Wall Street rivals such as Bear Stearns and Lehman Brothers, which made mortgage bets that Cantor and its publicly traded arm **BGC Partners** avoided. It led to increased issuance of government bonds, including the U.S. Treasuries that the two companies broker. It made smaller firms cheaper to buy and top bankers easier to hire. And it led to new regulation that could accelerate demand for the electronic trading that's core to his business.

So while other Wall Street houses are still dealing with the fallout from the crisis, Lutnick, 49, calls this "a great time to expand." He's opened new offices in São Paulo, Moscow, and Beijing. And he says he's determined to push Cantor beyond its traditional stronghold of bond brokering and make good on his long-standing ambitions to turn it into a full-service investment bank. Although it's hard to measure the success of his efforts so far, Lutnick says that if all goes well, he'd like to take Cantor public within the next two years.

Cantor is known as the firm that lost 658 of its 960 New York-based employees in the World Trade Center attacks. Lutnick, whose brother, Gary, died on Sept. 11, has steadily rebuilt a lucrative brokerage franchise while branching into businesses from e-commerce sites like **Delivery.com** to technology that lets Nevada gamblers bet on individual sports plays. He's had the resources to invest in new ventures, he says, because of conservative management: "We never had any debt. It's hard for bad things to happen when you have no debt."

Both Cantor and BGC act as middlemen, facilitating the trading of bonds, equities, and other finan-

cial products among large institutions. Cantor, a 65-year-old private partnership with nearly 1,400 employees, focuses on large clients such as hedge funds, insurers, and pension funds that lean on its expertise and relationships to make trades happen. BGC, which went public through a merger two years ago, has about 2,500 employees focusing on transactions among banks, a higher-volume, lower-commission business in which it relies heavily on its proprietary technology.

Lutnick is chairman and CEO of both companies, which share staff in such areas as public relations and human resources. He and executives of Cantor and BGC control over a third of BGC stock and more than 80 percent of its voting shares. "It's pretty much Howard Lutnick's shop," says Moody's Investors Service credit analyst Peter Nerby.

BGC's profits rose 44.7 percent last quarter, to $46.5 million, on a 14.4 percent increase in revenues, to $336 million. Its stock is up almost 50 percent since its 2010 low in February. Richard Repetto, an analyst with Sandler O'Neill & Partners in New York, calls BGC "well positioned" because of its relationships with banks and the likelihood that governments will keep issuing debt. The company, which has grown by opening new offices and acquiring smaller rivals around the world, trades about $720 billion of U.S. Treasuries, swaps, and other products daily.

Cantor doesn't disclose financial results, making it hard to judge its progress. It is trying to break into the business of making commercial loans and packaging them into securities, for example, aiming to sell $5 billion of such products a year. The prospects for that business are uncertain, says Darrell Wheeler, an analyst at Amherst Securities. Issuance of bonds backed by commercial mortgages is estimated to be less than $15 billion this year, down from $234 billion in 2007.

Cantor has also hired more than 50 investment bankers whose work has yet to show up in the usual rankings that chronicle the achievements of Wall Street's elite. It has barely taken part in the $3.3 trillion of U.S. bonds and syndicated loans underwritten by investment banks since 2008. Of the more than 40,000 mergers and acquisitions since 2008, Cantor has advised on only a handful, including the acquisition by its BGC unit of London broker **Mint Equities**. Steven L. Kantor, who joined the firm a year ago as head of global investment banking, dismisses such lists as meaningless. "I worry about profitability," says Kantor, who's working with clients like midsize companies, real estate developers, and entertainment figures looking to do private equity deals. For example, Cantor is helping reality-TV mogul Simon Fuller raise money for a fund to invest in entertainment ventures.

Having fought aggressively to recapture what was lost after Sept. 11, Lutnick is not about to pass up opportunities to grow. One thing he says he won't do is put the firm's capital at risk by starting a large proprietary trading operation, even if that means forgoing potential profits. His goal is to be a matchmaker and distributor. "We're not gambling," he says. "I don't want to lose." —*Diane Brady and Shannon D. Harrington*

The bottom line *Lutnick is aggressively expanding Cantor Fitzgerald and BGC and hopes to take Cantor public within two years.*

Lutnick's Ambitions



Cantor Gaming

The company is using its technology to allow Nevada sports gamblers to bet on individual plays during games. It hopes to expand the service to other gambling locations.



Entertainment Deals

Cantor is expanding its West Coast presence with new hires in Los Angeles. One goal: to put together buyout funds and other deals for wealthy investors.



A Public Offering

Lutnick took BGC Partners public through a merger in 2008. If all goes well, he'd like to see Cantor have an IPO within two years: "You have to make your people happy."



Trading Technology

BGC Partners invests $100 million a year to build on the market strength it has gained through proprietary electronic trading technologies such as eSpeed.



S&P 500
15.9%
July 2 – Oct. 18

Federal Spending

Health and Defense Stocks Are Suffering

▶ A Republican win may hurt government contractors

▶ "The market's looking through its binoculars [at] 2011 and 2012"

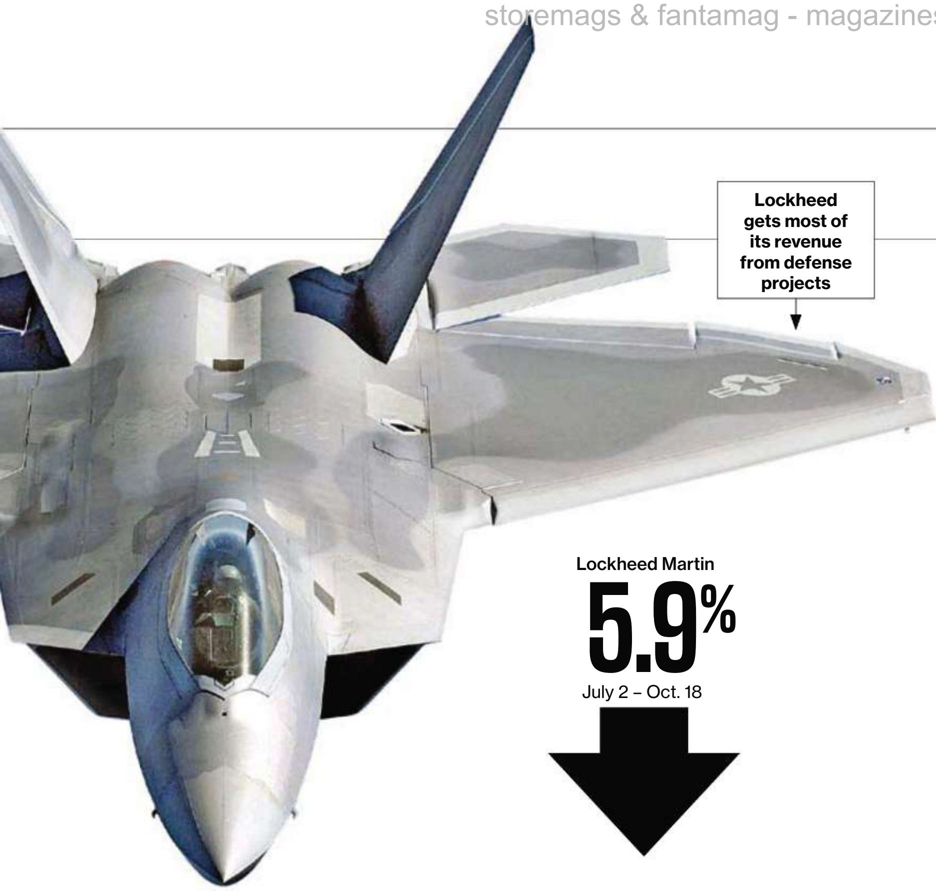
Companies that count on state and federal spending are trailing the Standard & Poor's 500-stock index for the first time in a year, a sign of concern they'll lose sales should Democrats give up control of Congress. **Lockheed Martin**, which gets almost all its revenue from defense projects, fell 5.9 percent from July 2 through Oct. 18 as the S&P 500 rallied 16 percent. **Tenet Healthcare** depends on the U.S. for a third of its revenue and is down 17 percent this year. "There's going to be a bridle put on U.S. government spending," says Keith Wirtz, who oversees $18 billion as chief investment officer at Fifth Third Asset Management in Cincinnati. "The market's looking through its binoculars and suggesting less government spending in 2011 and 2012 will hurt the fundamentals of these companies."

A Goldman Sachs index of contractors getting 20 percent or more of their revenue from governments,

FROM LEFT: ILLUSTRATIONS BY MATT OWENS; US AIR FORCE/ZUMA PRESS; YURI GRIPAS/REUTERS

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which includes Lockheed and Tenet, trailed the S&P 500 last quarter after beating it since September 2009. Investors at BlackRock, Fifth Third, and Harris Private Bank say budget cuts spurred by Republican victories in the House or Senate may lead to more declines in the shares. The party will hold a 20-seat majority in the House of Representatives following the Nov. 2 vote, according to projections by FiveThirtyEight, a *New York Times* blog that forecasts elections by analyzing polls. FiveThirtyEight projects that Democrats will have a four-seat advantage in the Senate.

House Republicans announced an agenda on Sept. 23 that would cut spending, extend expiring tax cuts, and repeal the health-care law President Obama signed in March. If they are able to follow through on those pledges, companies with the biggest share of sales to the government "will likely be passed over as we tighten our belts," says Jack Ablin, chief investment officer at Chicago-based Harris, which oversees $55 billion.

Lockheed won't be caught off guard. "We have undertaken a series of actions that are consistent with the new reality of a marketplace in which our customers are pursuing new productivity and savings goals," says Jeffery Adams, a spokesman for Lockheed. **ITT**, which gets 58 percent of its revenue from its defense segment, has trailed the S&P 500 by about 8 percentage points since July 2. David Albritton, spokesman for White Plains (N.Y.)-based ITT, didn't comment.

Tenet, the third-largest publicly traded U.S. hospital chain, enjoyed a brief rally on Mar. 22, when the House approved the health-care bill, which will extend benefits to 32 million uninsured Americans in 2014. "We saw health-care reform as a net positive for us over the long haul," says Rick Black, spokesman for Tenet, who says Medicaid and Medicare make up about one-third of revenue. "The more people that are covered will be beneficial to the whole system, as well as to hospitals like us." Black declined to comment on the revenue impact of the Republican agenda.

Shares of government contractors may bounce back as investors recognize that the threat of budget reductions is overblown, according to Scott Armiger, who helps manage about $5.6 billion at Christiana Bank & Trust in Greenville, Del. "Cutting government spending is a two-, three-step process," he says. "I don't see it happening in just one midterm election. These companies will be O.K. for the next couple of years. It's an overreaction to the downside, and it could actually be a buying opportunity." —*Inyoung Hwang and Whitney Kisling*

The bottom line *The prospect of Republican electoral gains is leading investors to shun stocks of companies that depend on government spending.*

Investing

Vanguard Takes on Two Leaders in ETFs

▶ Low-fee offerings help it beat BlackRock and State Street

▶ "Cost isn't everything, but it does matter," says an analyst

Vanguard's emphasis on low expenses and index investing have helped make it the largest mutual fund manager by assets in the U.S. Now it is using low costs to grab market share from **BlackRock** and **State Street**, the world's largest sellers of exchange-traded funds.

Vanguard ETFs sold in the U.S. pulled in a net $25.6 billion in the first nine months of this year, 26 percent more than BlackRock and State Street combined, according to Chicago-based research firm Morningstar. State Street and BlackRock dropped to a 70 percent combined share from 85 percent in 2005. Vanguard last month offered 20 new ETFs, taking on the bigger companies for the first time with funds that track broad market benchmarks including the Standard & Poor's 500-stock index and the Russell 1000.

ETFs, which trade through the day like stocks and usually track indexes, have been one of Wall Street's most popular products. Assets rose almost fourteenfold in the past decade, to $897 billion, Morningstar data show. ETFs may gather more deposits than index-based mutual funds this year. Through September, ETFs attracted $64.9 billion, compared

Quoted

"It's unfair to all of China's trading partners, Americans and others, because it just creates a playing field that's unbalanced."
—Treasury Secretary Timothy Geithner, saying China's exchange-rate policy is keeping the yuan undervalued





Raising a stein in Palestine
page 66 ▶

with $55.7 billion for index funds, according to Morningstar.

Fees charged by BlackRock and Boston-based State Street, which oversees $216 billion in ETFs, are on average about double those of Vanguard and **Charles Schwab**. The BlackRock iShares ETF that tracks an MSCI emerging markets index manages $48.2 billion and has an expense ratio of 0.72 percent. That means an investor who puts in $10,000 would pay $72 annually in fund fees. The fund, opened in 2003, gathered $2.7 billion this year through Sept. 30, according to data compiled by Bloomberg.

The Vanguard ETF that follows the same benchmark has an expense ratio of 0.27 percent. Opened in 2005, the fund drew $13.3 billion this year and assets have climbed to $39.9 billion. "Cost isn't everything, but it does matter," says David Nadig, director of research for Index Publications in Decatur, Ga., which produces a website covering the ETF industry. "For the more competitive segment of the market, investors are voting with their feet."

Both iShares and State Street say they aren't considering cutting expense ratios, except according to preset formulas that drop fees when the assets in a fund reach certain thresholds. "We are absolutely sticking to our strategy," iShares managing director Noel Archard says. "Our customers aren't asking for lower expense ratios. They're asking for more services." Those services include education on how to use ETFs, multi-ETF asset-allocation models, and portfolio analysis, he says.

A frequent advantage for State Street and BlackRock's iShares, with their bigger funds, is liquidity. The iShares $36.6 billion MSCI EAFE Index Fund, which tracks developed non-U.S. markets, charges 0.35 percent and had an average bid-ask spread of 2 basis points, or 0.02 percentage points, during normal trading hours in the week ending Oct. 8, Bloomberg data show. Schwab's similar $357 million International Equity ETF has an expense ratio of 0.13 percent, while its average bid-ask spread is 13 basis points, or 0.13 percentage points. "If the bid-ask spread is too large, perhaps because the fund is too small and liquidity is tight, you might end up paying more than you should, even if the underlying expense ratio is low," says George Padula, a wealth management adviser at Back Bay Financial Group in Boston, which oversees about $350 million, including $65 million in ETFs.

For active traders, the wider spread, which affects each transaction, is more of a burden than the expense ratio, which is an annual charge. The most active traders are large institutional investors, Index Publications' Nadig says. BlackRock and State Street are the world's largest money managers for institutions. Vanguard and Schwab, by contrast, cater mostly to retail investors, which may help them capture future ETF deposits. —*Christopher Condon*

The bottom line *Using the same low-cost strategy that helped it succeed in mutual funds, Vanguard is expanding its range of ETF offerings.*

Exchanges

Ending the Two-Hour Lunch in Hong Kong



▶ **Li wants to bring the trading day more in line with the mainland's**

▶ **"Waiting for the elevator alone could take 10 minutes during lunch"**

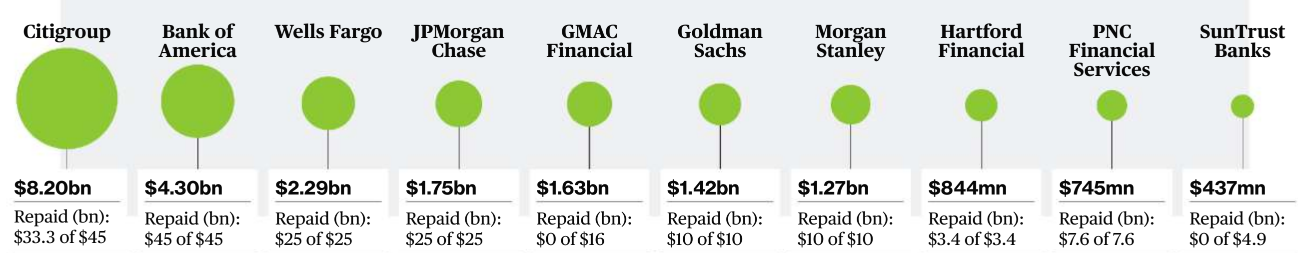
Equities traders in Hong Kong may soon have to say goodbye to lunches of sautéed ostrich and crispy pigeon at Michelin-starred restaurants and settle for a sandwich at their desks instead. Charles Li, chief executive officer of **Hong Kong Exchanges & Clearing**, wants to cut the two-hour break, the longest of the world's 20 largest bourses, and start trading a half hour earlier.

Li's goal is to align Hong Kong's trading hours more closely with the exchanges in Shanghai and Shenzhen, which open at 9:30 a.m. and have a 90-minute lunch break at 11:30. Under Li's plan, the opening of the Hong Kong market would move from 10 a.m. to 9:30 a.m., with a one-hour or 90-minute

Financial Crisis

The Treasury: Making Money on the Bank Bailout

The Troubled Asset Relief Program was designed as a bank rescue, not a profit-seeking investment. Even so, the Treasury is seeing returns–from dividends, interest, and warrants–on the $309 billion it plowed into banks and insurers. The chart shows the firms from which the Treasury has earned the most money so far, along with the amount of TARP funds they have repaid.



DATA: BLOOMBERG

FROM TOP: GETTY IMAGES; JEROME FAVRE/BLOOMBERG

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lunch break, and close at 4 p.m. Mainland companies accounted for 47 percent of the HK$19.69 trillion ($2.5 trillion) market value of Hong Kong's Main Board on Sept. 30, exchange data shows, up from 16 percent in 1997, when the U.K. returned Hong Kong to China.

Li invited brokers and investors at the Hong Kong exchange to respond to the proposal by Oct. 29. Bankers such as Alex Wong are not happy at the prospect of losing the two-hour lunch. "One hour just isn't enough," says Wong, asset-management director at **Ample Capital**, who uses the break for meeting clients and attending presentations. "Waiting for the elevator alone could take 10 minutes." Benson Chan, chief executive officer of **CASH Financial Services Group** in Hong Kong, supports the move, pointing out that some of his firm's brokers already trade for their clients from outside the exchange via mobile devices such as Apple iPads.

On the London Stock Exchange there hasn't been a lunchtime trading break since at least 1950, spokesman Jonny Blostone says, while New York had lost the luxury of a lunch hiatus by 1887. Frankfurt, Paris, and London open for more than 8 hours daily, while New York trades for 6½ hours. Singapore is proposing to boost its hours to 8 from 6½ by also cutting its lunch break. Tokyo is considering increasing trading to more than 6 hours from 4½.

47%

Mainland stocks' portion of trading on the Hong Kong exchange

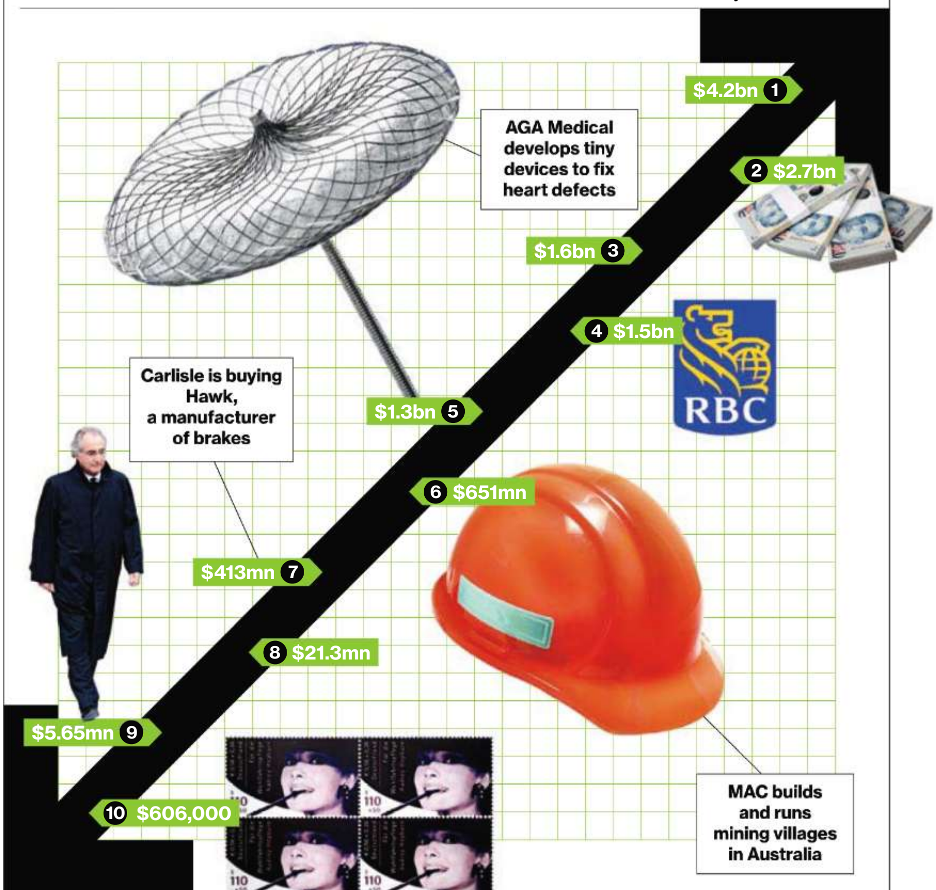
The two-hour lunch has been in place since the Hong Kong exchange was formed in 1986. The exchange gave up an effort to shorten it 7 years ago amid opposition from traders.

Now, as the exchange trades more mainland stocks, "it's only logical that trading times align more closely to the mainland," says Gavin Parry, managing director of **Parry International Trading**. "Shortening the market lunch break is another piece of the old-school brokers' life that is being dragged into modern times." B —*Hanny Wan*

The bottom line *With the Hong Kong exchange growing more dependent on mainland Chinese stocks, Li wants his hours to match the mainland's.*

Bid & Ask

by Cristina Lindblad



1 **Northeast Utilities** is merging with **NSTAR** in a $4.2 billion deal. The combined company will supply power and gas to over half of New England's customers.

2 **Global Logistic Properties,** a unit of the Government of Singapore Investment Corp., raised $2.7 billion in Singapore's largest initial public offering since 1993.

3 Russia's biggest oil producer, **Rosneft**, is buying Petróleos de Venezuela's 50 percent stake in a German refining venture for $1.6 billion to expand into Western Europe. The remaining 50 percent is held by **BP**.

4 **Royal Bank of Canada** is paying $1.5 billion for **BlueBay Asset Management**, a London-based manager of fixed-income funds with about $40 billion in assets under its control.

5 **St. Jude Medical** is acquiring **AGA Medical**, a Minnesota-based maker of devices used to treat heart defects, for $1.3 billion.

6 **MAC Services**, an Australian provider of services and housing for miners, accepted a $651 million bid from **Oil States**, a U.S. firm in the same business.

7 **Carlisle**, a U.S. maker of construction materials, tires, and trailers, is buying Ohio-based **Hawk**, for $413 million, to boost its brake business.

8 An Andy Warhol silk screen of shoes sold for nearly $2.6 million at auction in London, bringing **Sotheby's** total for its annual Frieze Art Fair contemporary art auction to $21.3 million.

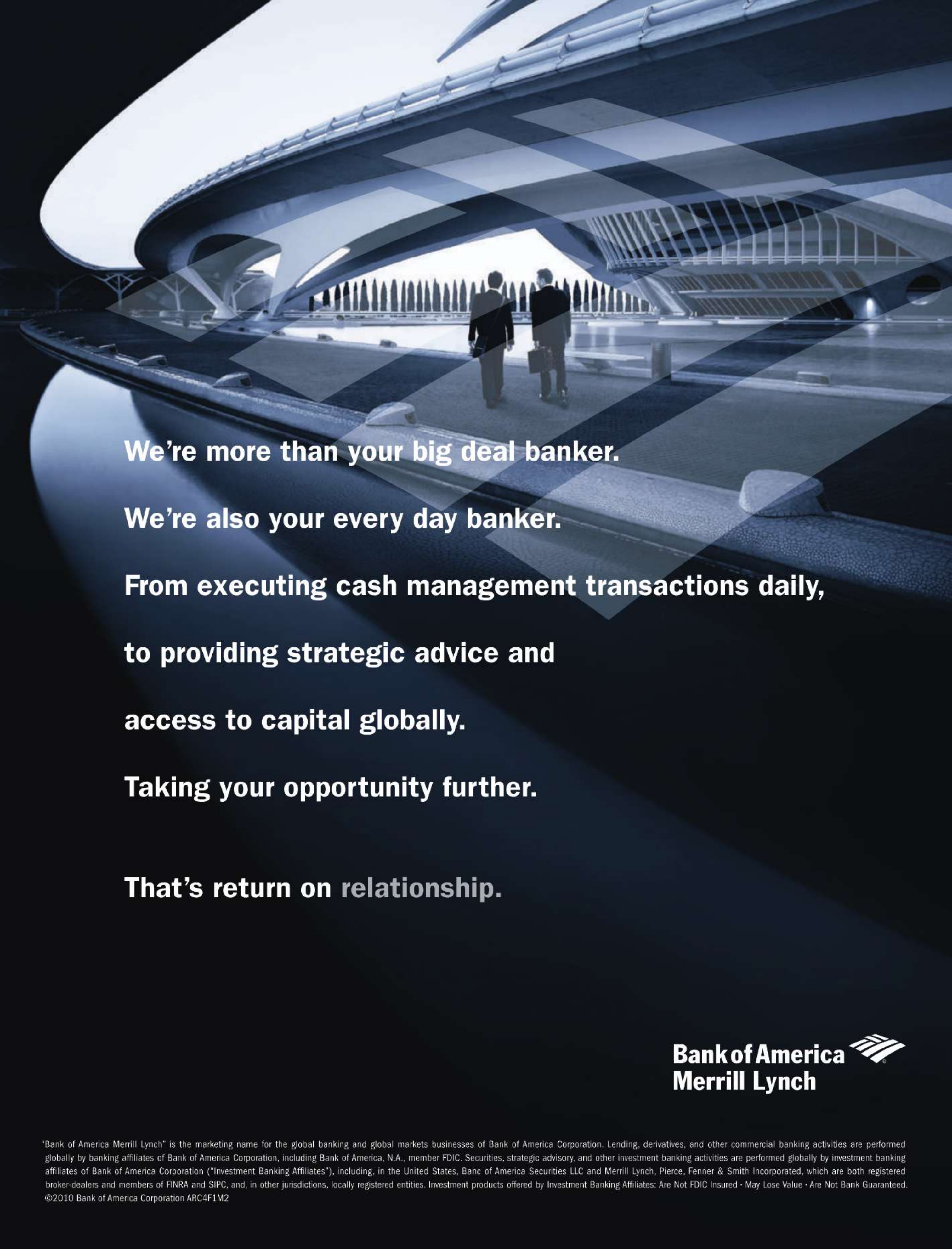
9 The Palm Beach, Fla., home of convicted Ponzi schemer **Bernard Madoff** was sold for $5.65 million, the U.S. Marshals Service reported. The property was listed for $8.5 million in September 2009.

10 A sheet of 10 stamps depicting **Audrey Hepburn** fetched $606,000 at a charity auction in Berlin. The Bundespost printed 14 million of the stamps in 2001 and destroyed all but a few sheets because of a copyright dispute.

FROM TOP: STUART JENNER/ALAMY; BRANDS OF THE WORLD; AGA MEDICAL CORPORATION; CREATIVEWAY/ALAMY; BRENDAN MCDERMID/REUTERS; KAI-UWE KNOTH/AP PHOTO

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Seibert's Knob Hall Winery in Maryland has gotten state aid to plant vines

Pouring Government Money Into Merlot and Chardonnay

▶ Despite scarce profits, states are stepping up their support for vineyards

▶ Viticulture "is at the core of agri-tourism, and states should do more" to fund it

Dick Seibert has lost money every year since he opened **Knob Hall Winery** in rural Maryland in 2006. Now he's looking for the financing needed to double his vines to 60 acres by yearend. "We're not making money yet, although we're not that far away," says Seibert, 58.

Seibert's optimism is buoyed by the silent partner he shares with many young wineries: his state government. He has received some $8,000 in aid from the state, including $1.50 of the $3.50 cost of each of the 4,000 vines he planted in his first two years. Five other vineyard owners in Maryland—where the number of wineries has doubled to almost 50 since 2005—are getting a total of $75,000 in state grants this year to expand production capacity. "The whole concept is to become a destination [for visitors] from Baltimore and Washington, a great day trip," says Seibert, sketching out his vision of a profitable future for the verdant hillsides, 75 miles from the capital, where his family has farmed soybeans and corn for more than two centuries.

All 50 states now have wineries, including 13 in Alaska and 5 in Hawaii

A decade ago, only a handful of states subsidized wineries, according to WineAmerica, the industry trade group. Now all U.S. states offer funding for them. Viticulture "is at the core of agri-tourism, and states should do more" to support it, says Cary Green, chief operating officer of WineAmerica. Texas, which has 212 wineries, allocates $2.3 million a year for wine research, marketing, and grants

PHOTOGRAPH BY ELIZABETH WEINBERG FOR BLOOMBERG BUSINESSWEEK

for producers, nine times the level in 2005. Ohio spent more than $1.1 million on subsidies for its wine industry in the 12 months through June, up 38 percent over the previous year. And Virginia dedicates 70 percent of its tax of 30¢ per bottle of wine—a total of about $1.3 million this year—to promote the industry.

The federal government is bellying up, too. The 2008 Farm Bill, which sets spending priorities through 2012, for the first time earmarked money to support specialty crops, including programs that help wineries. This year the U.S. will spend $500,000 on 18 Virginia projects, including pest control and a plan to map potential vineyard sites via satellite. An additional $40,000 of federal money will go toward encouraging alternative vine growing strategies in Idaho, and $9,000 will be spent to improve highway access to vineyards in Colorado.

47

PERCENT

Share of small business owners who say they won't retire until forced to for health reasons, according to a Wells Fargo/Gallup poll released Oct. 1, up from 40 percent in 2007.

There are now 6,600 wineries in the U.S., in all 50 states—even Alaska has 13 and Hawaii has 5—up from 574 in 34 states in 1975. Like Seibert's, though, few of these small businesses turn a profit in the first decade or two after they open. "It takes 5 years to get started, 10 years to have consistency, and when you get to 20 or 25 years old, from then on the vine gains complexity," says Andrew Bell, president of the American Sommelier Assn. in New York.

Nonetheless, state officials see vineyards as a smart investment. Beyond creating jobs in rural areas, officials say they keep family farms in business, attract vacationers and day-trippers, and raise revenue through alcohol taxes. "More than 1 million people visited [Virginia] wineries from out of state last year, so [vineyards] are a growing economic engine," says Todd Haymore, the state's Agriculture and Forestry Secretary.

To get more cash rolling in, many wineries are diversifying. In Morgantown, W. Va., **Forks of Cheat Winery** hasn't turned a profit since owner Jerry Deal planted his first vines 22 years ago. While he expects production to jump 10 percent this year, to 1,000 cases, he also has added fruit trees and blueberries to supplement the winery's revenue, and he's continuing to work his day job as a real estate appraiser. On New York's Long Island, **Bedell Cellars & Corey Creek Vineyard** has struggled for most of its 30 years of operation, despite winning accolades from *Wine Spectator* magazine. In 2003, Michael Lynne, executive producer of the *Lord of the Rings* trilogy, bought Bedell and poured millions of dollars into expansion and improvements, says the winery's CEO, Trent Preszler. To boost revenues, Lynne built a 4,000-square-foot mahogany deck for wine tasting parties and weddings. The operation still doesn't make



money. "It's a capital-intensive business," Preszler says. "It takes a lot of investment over a period of years."

Knob Hall's Seibert, a former lobbyist for the National Association of Manufacturers, inherited his family farm from an uncle. Although he had little capital, he grew convinced that the best way to keep the land in the family was to turn it into a vineyard, since soybeans typically pay about $200 an acre, vs. some $4,200 per acre for grapes. While every vintage still means more red ink, Seibert hopes to boost efficiency by planting more grapes and building his own production facility instead of leasing space at a nearby winery to make his wine. "I want to keep the family farm and keep it sustainable," he says. "There's nothing that I can see in agriculture right now that pays for the upkeep of a farm, except wine."
—*Keith F. Girard*

The bottom line *Government money is flowing into the wine industry, even though it takes decades for most vineyards to turn a profit.*

FROM TOP: PHOTOGRAPH BY ANDREW HETHERINGTON FOR BLOOMBERG BUSINESSWEEK; WILL RAGOZZINO/PATRICK MCMULLAN

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Benveniste: Skoopz is also in smaller stores such as this one in Atlanta

Consumer Products

Sweet-Talking Wal-Mart

▶ How two guys from Atlanta caught the eye of the giant retailer

▶ "We actually kind of freaked out" when Bentonville came calling

Go to one of more than 200 **Wal-Mart Stores** in Texas, and on the shelf next to **Cargill**'s Truvia sweetener is a startup brand called Skoopz. No one is as surprised as James Highsmith and Mark Benveniste, Skoopz's creators. Until a year ago, they had no particular expertise in the $400 million-plus artificial sweetener market. When the invitation to become a Wal-Mart vendor came by e-mail, "We actually kind of freaked out," Highsmith says in the conference room of a rented executive office suite just off Atlanta's Perimeter expressway. Down the hall, the pair's cluttered one-room office overflows with T-shirts and Skoopz packets in the company's signature day-glo orange.

Skoopz evolved from neighborly talk and a college connection. With startup financing from a silent partner, the men stumbled on a natural extract and created their own version of a tabletop sugar substitute that hit a price and taste sweet spot. Guerrilla marketing and help from a retail consultant in Bentonville, Ark., Wal-Mart's hometown, helped the fledgling company get its product into the giant chain.

Retail analysts say it's unusual for an unknown brand with no ties to any consumer products heavyweights to gain entrée to the company's stores. "A very small portion of the new products Wal-Mart sells are from small startup companies, because you have to be very sophisticated to work with them," says Leon Nicholas, senior vice-president of consultancy Kantar Retail.

Benveniste, 46, worked in telecommunications finance—and spent nearly four years in a federal penitentiary for bank fraud. "I did my time," he says. "I'm fortunate that I've been given a second chance." He and a third partner, who isn't involved in day-to-day management, met as neighbors near Atlanta. Casual conversations over yard work soon turned entrepreneurial. The neighbor, who doesn't want to be named, had already been talking about marketing natural products with Highsmith, 32, a college buddy who had worked in commercial real estate finance until his business collapsed during the recession. In late 2008, while still hunting for a product to sell, Highsmith invited Benveniste into the venture because of his retail marketing expertise. After his release from prison in 2007, Benveniste had been working for **On The Go Hosiery**, selling panty hose to retailers.

The Skoopz concept emerged seven months later during a meeting with an Atlanta health supplements maker. The manufacturer, which Skoopz's contract prohibits the men from naming, mentioned a stevia plant extract that it used to sweeten some of its products. Stevia extracts can be hundreds of times sweeter than refined sugar, yet they are noncaloric and natural. The Food and Drug Administration had green-lighted the extract the previous December, and Highsmith and Benveniste

➔

Quoted

"Forget about the IPO market. It doesn't exist."
—Alan Patricof, founder of New York venture capital firm Greycroft, on selling venture-backed companies today



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loved the sweetener's taste.

The men faced deep-pocketed competition. Cargill and **Coca-Cola** had teamed up on Truvia, and **Merisant** was working with **PepsiCo** on its version, PureVia. Both groups were pouring money into advertising around the U.S. Highsmith and Benveniste believed there could be room for Skoopz since Cargill and Merisant had cleared the way with regulators and boosted public awareness of stevia sweeteners.

The partners hired a food chemist to tinker with dozens of formulas until they found one they believed had less aftertaste and could be sold cheaper than rival products. (At Wal-Mart, a box of 100 packets of Skoopz is $5.98–the same price as 80 packets of Truvia.) They settled on the name Skoopz during a long Saturday night meeting at Benveniste's kitchen table. The name seemed a natural, Benveniste says, since "you go into a shop and say, 'Can I get a vanilla latte with two scoops.'" They chose orange for their packets to contrast with the blue, pink, and yellow packages already in restaurant sweetener caddies and the green used by Merisant and Cargill.

The men have gotten Skoopz into an Arkansas-based grocery chain called **Harps** and Atlanta area health food stores. And a retail contact in Bentonville liked the product and recommended it to a broker in town called Strategic Retail Solutions, or SRS. In December, Benveniste and Highsmith drove 13 hours to Bentonville in Benveniste's 1999 Dodge pickup to meet with SRS, which has close connections to Wal-Mart. Benveniste and Highsmith, though, thought it would take months to actually get in the door with the chain. "We didn't think that we would be able to fast-forward into it," Highsmith says.

SRS went to work selling Skoopz to Wal-Mart. In a guerrilla marketing effort, the men also planted their orange sweetener packets on restaurant tables, in churches, and at schools across Bentonville. It worked: Wal-Mart executives who had already happened on Skoopz around town were familiar with the brand when SRS made its pitch. In September, Wal-Mart began carrying Skoopz in Texas.

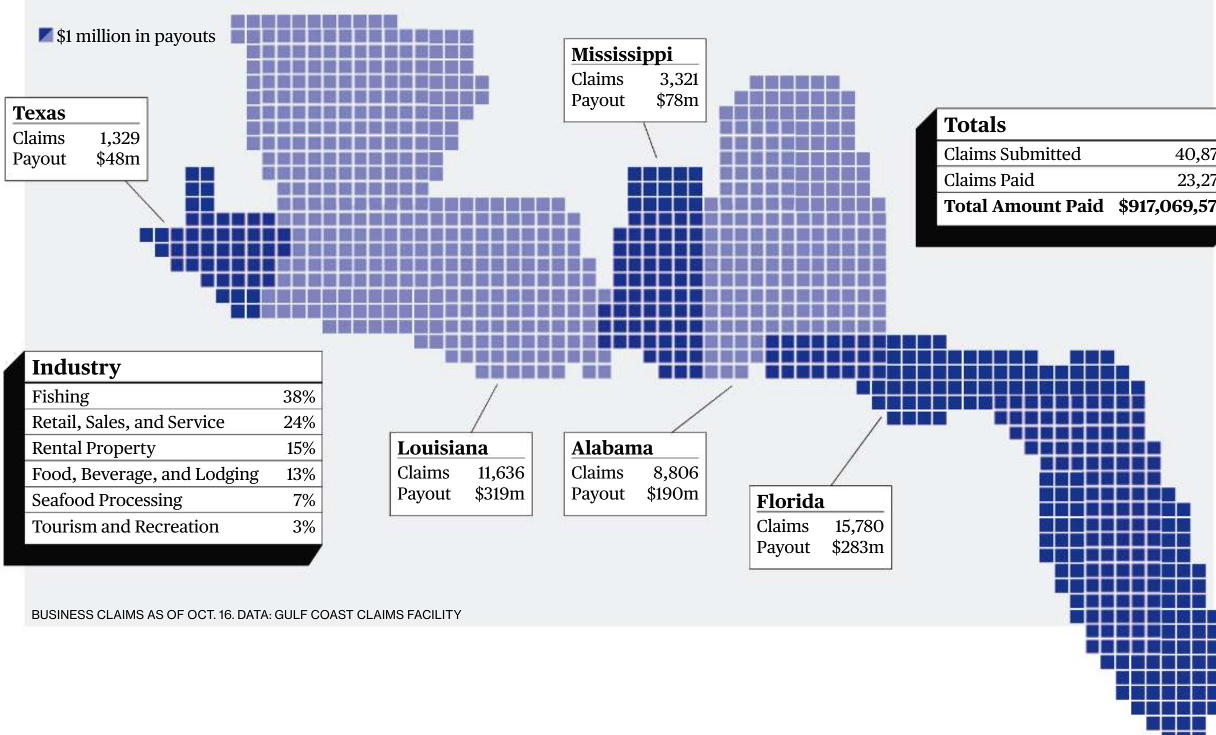
Highsmith and Benveniste expect Skoopz to be profitable early next year, though they decline to disclose revenue figures. Skoopz has bought ads on Texas radio, and if the sweetener does well at Wal-Mart the partners hope to take it national soon. "This is the opportunity to be in the world's largest retailer," Benveniste says. "It's not taken lightly." *—Duane D. Stanford*

The bottom line *With guerrilla marketing and some help from a Bentonville retailing consultant, an unknown brand managed to get into Wal-Mart.*

Disaster Relief

Where the BP Money Is Flowing

The $20 billion fund to compensate individuals and businesses for losses related to BP's Deepwater Horizon oil spill has paid more than $900 million in claims to companies. These payments–to businesses as diverse as shrimpers and oystermen in Louisiana, rental property owners in Alabama, fishing captains in Mississippi, and hotels and restaurants in Florida–range from just a few hundred dollars to $25 million. *—Nick Leiber*



Totals	
Claims Submitted	40,872
Claims Paid	23,272
Total Amount Paid	**$917,069,576**

Industry	
Fishing	38%
Retail, Sales, and Service	24%
Rental Property	15%
Food, Beverage, and Lodging	13%
Seafood Processing	7%
Tourism and Recreation	3%

BUSINESS CLAIMS AS OF OCT. 16. DATA: GULF COAST CLAIMS FACILITY

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Enterprise



Santiago: Start-Up Chile has approved 25 projects this year

Policy

Chile Aims to Attract Foreign Startups

▶ The government is dangling visas and $40,000 grants

▶ "I can't think of a cheaper public policy to ... gather talent"

Like so many young entrepreneurs, Stanford University grads Amit Aharoni and Nicolas Meunier had an idea for a business: a website to help Americans find deals for cruise-ship vacations. Unlike many other entrepreneurs, though, they didn't launch their company in Silicon Valley, opting instead to go nearly 6,000 miles south, to Santiago, Chile.

Aharoni, a 30-year-old MBA who spent nine years in the Israeli Defense Forces, and Meunier, 25, a programmer from France with a masters in electrical engineering, are the first participants in Start-Up Chile, a government program to woo foreign entrepreneurs. The goal is to put Chile on the map as an innovation hub. "We wouldn't have come to Chile if it hadn't been for the program," says Aharoni. "It's not something that you might consider naturally."

Start-Up Chile is trying to tackle what President Sebastián Piñera calls an obstacle to growth: a dearth of entrepreneurs. Shortly after taking office in March, the billionaire, who made his fortune introducing credit cards to the country, pledged to add 100,000 businesses and 800,000 jobs by 2014. In a July speech, Piñera said Chile needs to look outside its borders and "work hard to regain its entrepreneurial and innovative culture."

Nicolas Shea, a Chilean who had been running an e-learning company in Silicon Valley, moved back to Santiago to help run Start-Up Chile. The program will have a budget of $1 million this year and $5 million in 2011. More than 150 people, with ideas ranging from software to solar panels to gadgets that use radio-frequency identification technology, have applied to the program. Those who make the cut will receive a $40,000 grant, a one-year residency visa, and hand-holding from the program's seven-person team to ensure participants settle in quickly and make connections with potential hires and investors.

The program's five-person selection committee has approved 25 companies this year, most of them submitted by foreign-born residents of the U.S. The idea is to borrow talent, not steal it, Shea says. "It would be ridiculous to want to compete with Silicon Valley or Bangalore. ... But we want to be in the game as an agile, friendly player—a good place to do a test market," he says. "I can't think of a cheaper public policy to gather all the talent that we will gather."

Detractors have questioned why Chilean citizens can't apply for the grants. In comments on blogs and via Twitter, they argue that subsidies should be awarded to Chileans to develop the country from the inside. Supporters of the program counter that foreigners will help create jobs and serve as an inspiration to locals. Chileans will see that "taking the entrepreneurial plunge is possible, because here comes this [foreign] guy with an idea ... and it got funding," says Alex Seelenberger, managing director at Aurus Bios in Santiago, one of Chile's 20-plus venture capital firms.

For Aharoni, the program is paying off more quickly than he expected. He and Meunier have already met with several Chilean investors and plan to have a demo up and running by January, which they intend to use to raise money. Although Aharoni acknowledges salaries for software developers in Chile "are much closer to Silicon Valley than China or India," he says the Start-Up Chile staff has provided valuable help in setting up meetings with potential partners. "We started seeing that our schedule is more and more filled," Aharoni says. "It's at least as filled as it was in California, business-wise and social-wise." —*Nick Leiber*

The bottom line *Chile hopes to lure foreign entrepreneurs with $40,000 grants and a business incubation program for promising startups.*

Unsolicited Advice

Paul Graham, author, programmer, and tech investor

You have to overcome your pride. If you have some initial idea, and you spend a year on it, all you will have made, probably, is a really well-built mistake. By launching to the public instead of simply having some theoretical model, you will have actual customers bitching at you because your software doesn't do what they want. Customers are almost perversely different than you imagine them to be.



Graham's venture firm, Y Combinator, has funded 208 startups, including Airbnb and Dropbox

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Brewing

In the West Bank, a Palestinian Oktoberfest

▶ After years of trouble, a brewery in a Christian enclave is building sales

▶ "We are running this business against all odds"

The second Intifada, Nadim Khoury says, may have been the low point for his family's business. As owner of the only brewery in the West Bank, though, he has faced plenty of other troubles even without the years of violent insurrection. There's the disdain that many of his Muslim neighbors have for alcoholic beverages. There are the Israeli checkpoints where beer can spoil as delivery trucks wait for hours under the hot Levantine sun. There's the lack of any outside financing for such an unlikely enterprise. "We are running this business against all odds," says Khoury, 51, who with his brother, David, 15 years ago started **Taybeh Brewing** in Taybeh, a town of about 1,600 residents 20 miles north of Jerusalem.

After years of scraping by, the brewery today returns a decent profit and is expanding to meet growing demand. The company has 15 employees, and sales in 2009 topped $1.5 million, with production up 25 percent in the past two years. "We do this due to our shared love of the motherland and making beer," says Nadim, who discovered his passion for brewing three decades ago and went on to study beer production at the University of California at Davis.

Nadim Khoury returned to Taybeh, his family's ancestral village, after nearly two decades in Boston, even as other Palestinian Christians were abandoning the West Bank. David joined him there in 2000. The brothers and their father sold stocks, a house, and two liquor stores in Massachusetts to come up with the $1.2 million they needed to start Taybeh Brewing. "People thought we had gone completely nuts," says Nadim.

A sign of Taybeh beer's popularity? Growing sales to Muslims, says Nadim Khoury

In 2005, David Khoury, 54, was elected mayor of Taybeh, the last all-Christian town on the West Bank. As mayor, he has promoted Oktoberfest, the annual autumn celebration of beer culture, to draw tourists to the town–and sell more brew. "We are creating a sense of normality for Palestinians," says David, his dark suit soaked in sweat from the stifling heat as music from this year's celebration seeps through the windows of the one-story concrete building that serves as Taybeh's city hall. "It's great to be able to bring so many people together."

Over the weekend of Oct. 2, the Taybeh Oktoberfest drew thousands

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Oktoberfest featured grilled lamb, hip-hop, and plenty of beer

of beer fans to the hilltop town where Jesus is said to have walked. Visitors watched a Brazilian bossa nova band, Palestinian hip-hop performers, and Sri Lankan traditional dancers. The menu featured pita with Labaneh cheese, falafel sandwiches, grilled lamb skewers, and blonde and dark brews from Taybeh—which, in a fortunate coincidence for the brothers, happens to mean “delicious” in Arabic. “They make great beer, which you can’t find anywhere else in Palestine, so people come here to just let go,” says Jeries Zahran, a 20-year-old management student at Bethlehem University.

The Palestinian insurrection known as the second Intifada nearly scuttled the business. After the fighting began in 2000, the West Bank was plunged into five years of violence and chaos, and the brewery’s output fell by 90 percent because few people could afford luxuries such as beer. Since the worst of the fighting wound down about five years ago, production has climbed steadily. This year it will hit 600,000 liters, 20 percent more than Taybeh produced before the Intifada. The Khourys are now buying four fermentation tanks and hope to increase production 50 percent next year.

About 30 percent of the Khourys’ beer is sold in Israel. Although the brothers spend almost nothing on advertising, they have built a thriving market in a handful of pubs and restaurants such as Jerusalem’s American Colony Hotel, a watering hole for many diplomats and journalists. David says they would like to find a distributor in Israel to help increase sales. An additional 10 percent of production is shipped overseas, much of it to Japan, where importer Yoshihiko Miyazawa has helped establish the

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COMCAST BUSINESS CLASS

LESSONS LEARNED

Lesson 6: An Online Presence Yields More Customers and Profits

In order to successfully compete in the local or global marketplace today, small businesses must establish an online presence. The Internet has transformed how, where and when business is conducted, creating opportunities for savvy entrepreneurs and leaving disconnected companies lagging behind. Setting up shop online provides a number of advantages, including the following four major business boosters.



Broadening Your Potential Customer Base

Many businesses start out targeting a specific audience —often local—but soon realize the power of the Internet to remove geographic restrictions. Bert Martinez, CEO of Houston-based Bert Martinez Communications, LLC (www.bertmartinez.com), provides training to entrepreneurs, business owners and corporate employees on marketing, sales and business strategies via one- and two-day in-person seminars. Although Martinez's training attracted attendees from across the U.S., by converting his live training to Internet-based programming in early 2010, he now has international participants from as far away as Japan and Australia, who can receive instruction entirely via the web. He anticipates the firm's 2011 revenue will be double its 2010 results.

Allowing More Local Targeting

Leveraging Internet technology also makes customer targeting more precise. "The Internet allows us to be competitive with national firms and enables us to really target customers not just based on demographics, but also psychographics," says Chuck McCabe, CEO of The Income Tax School, Inc. (www.theincometaxschool.com) and Peoples Income Tax, Inc. in Richmond, Virginia. McCabe reports his firm can market its tax school much more efficiently and effectively using online marketing tools such as paid search (pay-per-click advertising).

Many businesses start out targeting a specific audience—often local—but soon realize the power of the Internet to remove geographic restrictions.

Creating a New Delivery Platform

Until 2003, McCabe's firm published hardcopy instruction guides and sold them to other tax firms as teaching tools for income tax preparation. That year, McCabe decided to create an ecommerce website to market directly to students. To deliver e-learning courses, he uses a customized learning management system managed by a third-party provider.

In addition to reducing his production costs by converting books to digital, McCabe increased his target market from 200 potential licensees at other tax firms to more than 1 million potential students—enrolled income tax preparers in need of continuing education.

Shrinking Marketing Expenses

Internet marketing can also be much more cost-effective than traditional tools, reducing promotional costs and increasing profitability. Martinez used to spend up to $1,000 per seminar on books distributed to attendees. Now that his training is almost entirely provided online, the cost of bonus materials has dropped to nothing.

McCabe says, "The Internet has become our primary marketing tool," and, because marketing campaigns can be much more targeted to particular types of customers, the business has cut its marketing budget in half in the last year with improved results. Being able to spend less and increase sales should be reason enough to establish an online presence.

For more tips on running your small business and how Comcast Business Class can help, visit **business.comcast.com**.

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Enterprise

brand. "Palestinians have a very rich culinary culture, and the Japanese like that," Miyazawa says as he quaffs a Taybeh lager at the Oktoberfest.

It's the brewery's home market, though, that's growing the fastest. Taybeh is surrounded by Muslim towns, so the Khoury brothers have added non-alcoholic beer to their lineup. On the eve of last year's Oktoberfest, someone tossed a Molotov cocktail at David's car, an attack townspeople believe may have come from Islamic extremists who oppose alcohol consumption, though no one has been arrested. Nonetheless, Taybeh beer is getting more popular in pubs in West Bank towns such as Ramallah and Bethlehem–which Nadim says is likely due to growing sales to Muslims. "The amount of alcohol we sell in the Palestinian territories," he says, "cannot be drunk by the Christian population only." —*David Wainer*

The bottom line *After nearly being driven out of business by the Intifada, a brewery in the West Bank is expanding to meet demand.*

Hiring

The Struggle to Recruit Tech Talent

▶ **Startups vie with bigger rivals as demand for programmers returns**

▶ **Wanted: Software Engineers**

Percent change in job postings, year over year



DATA: DICE.COM JOB POSTINGS

At FounderDating events, designed to match aspiring entrepreneurs with business partners, the organizers try to keep the crowds split evenly between those with technical skills and those with management expertise. That's not easy in Silicon Valley these days. If 200 people apply to attend the invitation-only programs, 125 are businesspeople, not engineers, says Jessica Alter, who started FounderDating a year ago in San Francisco with venture capitalist Saar Gur. "It's really important to have people with complementary skill sets," Alter says.

In many industries, high unemployment means abundant available labor. That's not the case for fledgling tech companies making their crucial first hires. They report that finding software engineers is as hard as it was during the boom. Tech jobs site **Dice.com** reports a 38 percent jump in postings by employers over the past year, and listings for tech positions at **TheLadders**, another jobs site, are up 65 percent. The Bureau of Labor Statistics reports that employment in computer systems design and related services rose 2.8 percent between the beginning of the recession in December 2007 and this September. Over the same period, nonfarm payrolls fell 5.6 percent. "A year ago engineers were getting one offer and taking it," says TheLadders Chief Executive Officer Marc Cenedella. "Now we're seeing engineers with two, three, or four offers."

The growing demand for engineers squeezes startups because it's hard for them to compete for talent with big tech companies. Founders of startups and hiring experts say many engineers now favor stability and higher pay over the promise of stock options in a young company. "They know that game and think it's bullshit," says Joe Stump, co-founder of **SimpleGeo**, a startup that provides location data to smartphone app developers. Bigger companies such as **Twitter**, **Facebook**, and **Google** "obviously can offer higher salaries and better benefits packages," Stump says.

Fast-growing tech startups also find they need more engineers at earlier stages than in the past. **Formspring**, a site where people post questions for others to answer, launched last November. By January it had 1 million users, and today it has 17 million. (Facebook took three years to reach that level.) At peak times, Formspring users post 10,000 answers per minute, says CEO Ade Olonoh. "It's really more hard-core engineering that needs to go behind sites like ours," he says. His company has grown from 5 employees to 17 since moving from Indianapolis to San Francisco in March. Olonoh says he'd like to hire even faster. "It's not like we post a job and get 100 great

Software

Keeping the Books for Small Biz

Since its launch 12 years ago, Intuit's QuickBooks has dominated the market for small business accounting software. Now dozens of startups are challenging QuickBooks with new online tools that aim to make accounting and financial management easier. Here are some fast-growing new rivals. —*Venessa Wong*

Outright	**Xero**	**inDinero**	**Kashoo**
Users: 100,000	**Users**: 22,000	**Users:** 6,000	**Users:** 2,400
Price: Charges only for tax filings–$5 per 1099 form	**Price:** $19-$39 monthly	**Price:** Basic version is free; enhanced services $30-$100 monthly	**Price:** $10 monthly for unlimited users at a company
Backers: Sequoia Capital, First Round Capital, Shasta Ventures, SoftTech VC, Felicis Ventures	**Backers:** Founder Rod Drury and board members Sam Morgan and Craig Winkler; publicly traded since 2007	**Backers:** Y Combinator, YouTube co-founder Jawed Karim, Eventbrite CEO Kevin Hartz	**Backers:** Canadian tax preparation firm FBC
Synchronizes with bank, credit-card, and PayPal accounts, categorizes income and expenses, and calculates taxes.	*Organizes a company's bank and credit-card accounts, expenses, invoicing, and contacts. New Zealand-based Xero offers limited services to American users today, but is upgrading its U.S. site in December.*	*Organizes and analyzes information from credit-card and banking accounts to create financial reports and graphs and offers algorithms to forecast a user's cash flow.*	*Helps users create audit-ready, shareable financial statements. By yearend, companies will also be able to automatically synchronize their bank and credit-card accounts with Kashoo accounts.*

DATA: COMPANIES; REGISTERED USERS FOR OUTRIGHT, ACTIVE USERS FOR THE OTHERS

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Enterprise

Why is this fish so popular? page 88 ▶



applicants," he says. "It's harder to find people than most might think."

These days, engineers with their own ideas can also launch companies without partners that have business and fundraising expertise. "It has become much easier to start a company financially. You don't need millions of dollars for servers," says FounderDating's Alter. Nontechnical founders, by contrast, still need engineers to turn ideas into products, Alter says.

Logan Green, co-founder and CEO of **Zimride**, a Palo Alto (Calif.) ride-sharing website with 10 employees, has been trying to hire three engineers since raising $1.2 million in August. With most talented engineers already happy in their work situations, he says, "they're not going to be looking on job boards or talking to recruiters." Although he got scores of résumés, Green says few of the job seekers have the right experience, so he's tapping his investors' networks to find more candidates. As a young company, "you're going after the top echelon of talent," he says, "with the least amount of resources." *—John Tozzi*

The bottom line *As demand for software engineers has increased after the recession, startups are finding it harder to recruit technical talent.*

Finance

Small Companies, Big Borrowing Costs

▶ Low bond yields don't translate into easier credit for small business

▶ "A divide has opened between large firms ... and small firms"

Demand for corporate bonds and an ultraloose monetary policy in the U.S. have translated into record-low borrowing costs for large companies. For small businesses, though, getting credit remains plenty difficult.

U.S. corporations issued more than $355 billion in bonds in the third quarter, 32 percent more than in the same period last year, according to data compiled by Bloomberg. **Wal-Mart Stores** sold $5 billion of bonds on Oct. 18, some of them at the lowest interest rates ever, according to **Bank of America**. "Larger companies can go to the market, and that market is largely repaired," says Adolfo Laurenti, deputy chief economist at Mesirow Financial, a money manager in Chicago. Smaller companies that don't have access to the bond market "need to go through some intermediary such as banks, [which] have become very risk-averse."

Although some banks have increased credit in recent months, much of that is due to banks buying securities rather than making loans to small businesses. In the 12 months through August, rates on commercial and industrial loans of less than $100,000 climbed to 8.95 percent from 8.45 percent. Meanwhile, banks pared commercial and industrial lending–loans typically used by companies without access to the bond market–by 11.3 percent in the past year, Federal Reserve data show. "A divide has opened between large firms that are able to tap public securities markets and small firms that largely depend on banks," Fed Chairman Ben Bernanke told a gathering of central bankers in August in Jackson Hole, Wyo.

Mel Hodges feels the pain. Last spring he wanted to increase his bank credit line to $40,000 from $25,000 so he could add a sixth employee at Hodges Technologies, his computer business in Easton, Pa. His bank instead said it might cut the line in half. Although he finally persuaded the bank to maintain his line at $25,000, he didn't make the hire and doesn't expect to anytime soon. "It's a great life being in business, but many nights it keeps you up trying to figure out how you're going to make payroll," says Hodges, 55, who uses the credit line to cover salaries when customers are slow to pay their bills.

The reluctance of bankers to offer loans isn't the only reason for the borrowing slowdown. There's also a lack of demand for credit from many small businesses, which are waiting for sales to pick up before expanding, says Robert Seiwert, senior vice-president at the American Bankers Assn. "Economists have indicated that the recession is over," Seiwert says. "But most small business owners haven't seen that recovery in terms of customers walking through the door." **B**

—Christine Richard and John Detrixhe

The bottom line *Record-low borrowing costs for the biggest U.S. companies aren't trickling down to their smaller counterparts.*

Speed Dial
Dina Kaplan

The former TV news reporter and co-founder of Web video startup blip.tv says women tech entrepreneurs should help one another

Women start high-growth or venture-backed companies at a much lower rate than men. Why?
Many founders of scalable Internet companies are engineers and programmers. There are far fewer women in that field than men. We need to encourage more girls and teens to consider going into programming.

So there's a lack of role models?
I could name for you the women who are prominent founders in our field, and that's sad. You have Caterina Fake, you have the women who founded the Gilt Groupe, you have Leah Culver who was involved in Pownce, but you can't list off dozens of women founders of Internet companies.

You've said women founders are sometimes held to a different standard than men. How so?
It's fair to say that people have their eye on you, which comes with positives and negatives. It can help in the sense that people will remember you, they'll notice you at meetings, and that's a really strong positive. It has a potential to run negative as well, if you don't fit the perfect stereotype of an entrepreneur. There's an expectation that the next Mark Zuckerberg will look like Mark Zuckerberg.

How can women in tech and media support each other?
There is a very strong camaraderie emerging among women in digital media. Women founders can encourage friendships and build a support network and potential business relationships to try to create a bit of an "old girls' club" for digital media. **B**
—John Tozzi

PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

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Mark Pinsky

Help for Small Businesses: Loans Are Just the Start



Community lenders pioneered a model for financing small businesses in poor areas. Now they're playing a bigger role in the recovery

When Hurricane Ike wrecked Arga Bourgeois' health food store in Houston's impoverished Third Ward two years ago, her landlord didn't want to repair the building. Facing a shutdown, Bourgeois went to Accion Texas, a nonprofit that three years earlier had loaned her the money she needed to expand her store after banks had spurned her. This time Accion fronted Bourgeois $30,000, and by the spring of 2009 Sunshine's Health Food Store and Vegetarian Deli was back in business.

Bourgeois is quick to say that money from Accion Texas has been instrumental in her success. Just as important, though, has been Accion's business counseling. Advisers from the group have helped her develop a marketing strategy, better manage inventory, and improve cash flow. "Accion Texas didn't just say, 'Here you are, take it and you're on your own,'" Bourgeois says. "I also received education through them, a lifetime of learning and resources, and that's what I appreciate most."

Her store is one of more than 50,000 small businesses in America's low-income neighborhoods that have benefited from the combination of flexible financing and nitty-gritty technical assistance provided by groups like Accion. The first of these lenders, known as CDFIs—community development financial institutions—were formed in the early 1980s. Since then the industry has grown to more than 700 institutions, including loan funds and equity funds as well as credit unions and banks. All told, they manage $30 billion-plus in assets, in cities and rural areas and on Native American reservations.

CDFIs were initially financed by socially motivated investors, particularly faith-based groups such as nuns investing their retirement funds. Today, most new capital comes from commercial banks. In the past year more than $1 billion in investments from the likes of Goldman Sachs, Citi, JPMorgan Chase, Wells Fargo, and Bank of America has flowed to CDFIs for small business lending. The government is helping, too: The Treasury Dept.'s support for CDFIs increased 70 percent, to $247 million, in the last fiscal year.

These institutions have succeeded with the kind of financial discipline that many lenders forgot during the credit bubble. They have an incentive to make sure their clients succeed because CDFIs, not their investors, take the initial financial hit if borrowers don't repay their loans. In the three decades through 2008, only about 1 percent of their loans weren't paid back, according to the CDFI Data Project, an industry research collaborative that my company participates in. When problem assets and delinquencies spiked in the second half of 2008, CDFIs aggressively charged off possible losses and wrote down asset values at the first signs of trouble.

CDFIs have succeeded with the financial discipline that many lenders forgot during the credit bubble

Perhaps most important, CDFIs recognize the challenges that borrowers have and address them with technical assistance: advice, mentoring, and hands-on help for everything from bookkeeping to business strategy. They stay in close contact with loan recipients, routinely knocking on a borrower's door if payment is even one day late. Lenders that need to maximize profits can't afford to give clients such close attention. CDFIs, which are profitable but not profit-maximizing, can.

When the economy contracts, the market for CDFIs expands, and since the recession they have been transforming lower-income neighborhoods, one transaction at a time. For example, the renewed national focus on healthy foods led by First Lady Michelle Obama draws heavily on the success of a Philadelphia-based CDFI, The Reinvestment Fund, which has financed more than 85 food stores in distressed communities across Pennsylvania. The Obama Administration's Healthy Food Financing Initiative aims to replicate The Reinvestment Fund's model to make healthy foods available in low-income communities nationwide.

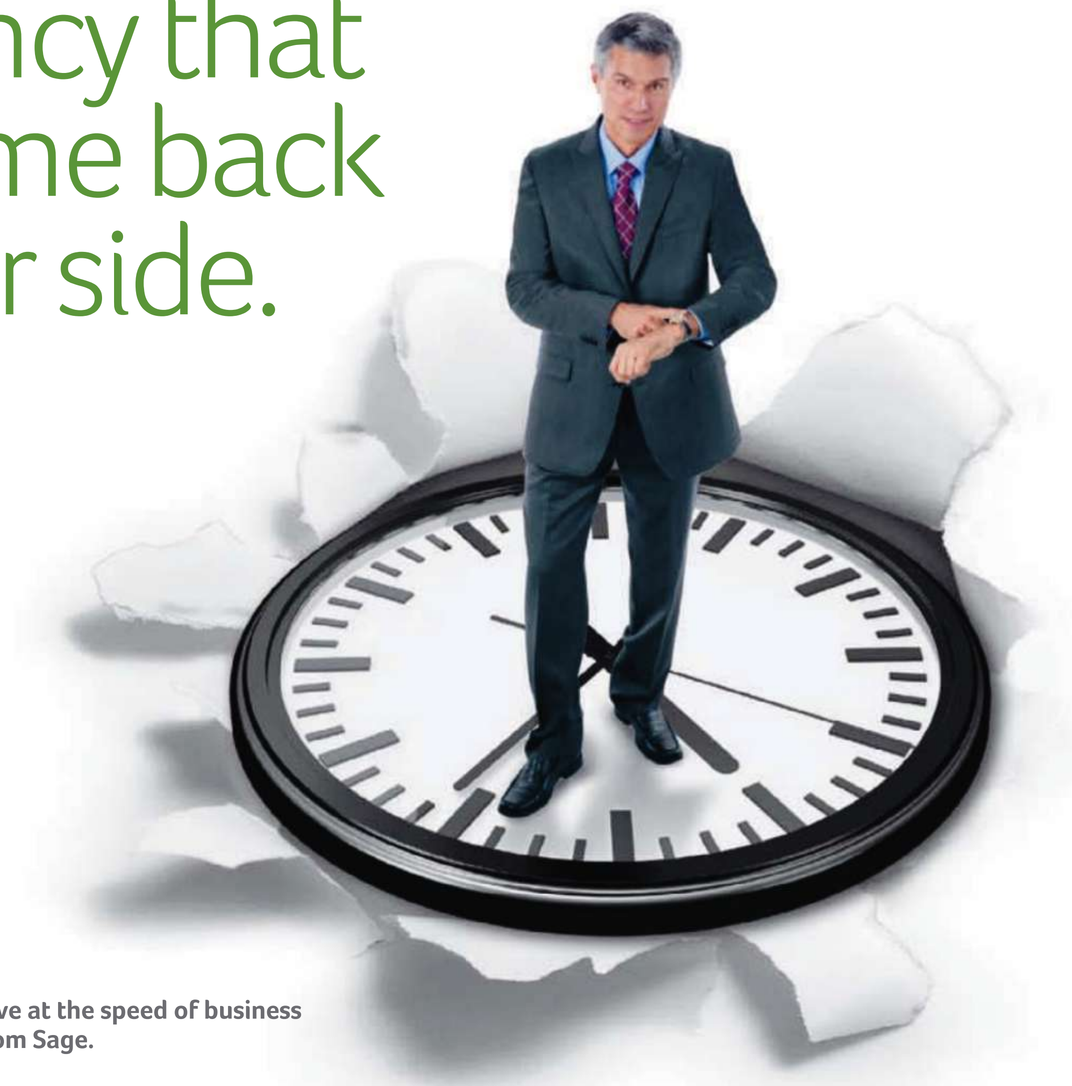
The CDFIs' model of responsible lending helped such groups weather the downturn better than many other financial institutions. Today, most CDFIs are recovering rapidly, and they continue to pair their loans with the help that ensures borrowers will be able to pay them back. When you're lending nuns' retirement money, safety and soundness take on a unique imperative. B

Mark Pinsky is president and CEO of Opportunity Finance Network, an organization of more than 170 U.S. community lenders.

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Joseph Lents hasn't paid his mortgage

SINCE 2002

But the loan's owner can't foreclose—it can't produce his paperwork

That's just one of the battles inside the U.S. foreclosure crisis, a titanic clash between:

LENDERS

LOAN SERVICERS

BOND-HOLDERS

HOMEOWNERS

AND TAXPAYERS

The Core Issue:

Who'll get stuck with $1 trillion or more in losses on housing debt?

SHREDDING THE DREAM

BY PETER COY, PAUL M. BARRETT, AND CHAD TERHUNE

In 2002, a Boca Raton (Fla.) accountant named Joseph Lents was accused of securities law violations by the Securities and Exchange Commission. Lents, who was chief executive officer of a now-defunct voice-recognition software company, had sold shares in the publicly traded company without filing the proper forms. Facing a little over $100,000 in fines and fees, and with his assets frozen by the SEC, Lents stopped making payments on his $1.5 million mortgage.

The loan servicer, Washington Mutual, tried to foreclose on his home in 2003 but was never able to produce Lents' promissory note, so the state circuit court for Palm Beach County dismissed the case. Next, the buyer of the loan, DLJ Mortgage Capital, stepped in with another foreclosure proceeding. DLJ claimed to have lost the promissory note in interoffice mail. Lents was dubious: "When you say you lose a $1.5 million negotiable instrument—that doesn't happen." DLJ claimed that its word was as good as paper. But at least in Palm Beach County, paper still rules. If his mortgage holder couldn't prove it held his mortgage, it couldn't foreclose.

Eight years after defaulting, Lents still hasn't made a payment or been forced out of his house. DLJ, whose parent, Credit Suisse, declined to comment for this story, still hasn't proved its ownership to the satisfaction of the court. Lents' debt has grown to about $2.5 million, including unpaid taxes, interest, and penalties. As the stalemate grinds on, Lents has the comfort of knowing he's no longer alone. When he began demanding to see the I.O.U., he says, "I was looked upon like I had leprosy. Now, I have probably 20 to 30 people a month come to me" asking for advice. Lents is irked when people accuse him of exploiting a loophole. "It's not a loophole," he says. "It's the law."

The Lents Defense, as it might be called, doesn't work everywhere. Thousands of Floridians have lost their homes in lightning-fast "rocket dockets." In 27 other states, judges don't even review foreclosures, making it harder for homeowners to fight back. Now, though, allegations of carelessness and outright fraud in foreclosures has become so widespread that attorneys general in all 50 states are investigating. So are the feds.

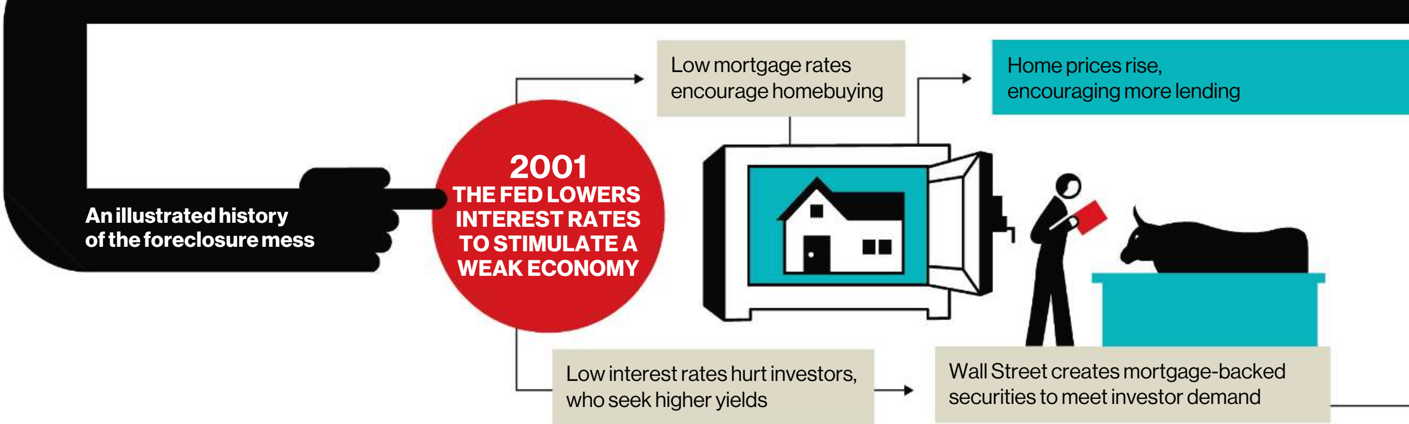
Even if the documentation problems turn out to be manageable—as Bank of America and others insist they will be—the economy will still suffer long-term consequences from the loose underwriting that caused the subprime housing bubble. According to an Oct. 15 report by J.P. Morgan Securities, some $2 trillion of the $6 trillion in U.S. mortgages and home-equity loans that were securitized during the height of the bubble, from 2005 through 2007, are likely to go into default. The report says the housing bust will ultimately cause losses of $1.1 trillion on those bonds.

While banks and investors take their hits, millions of homeowners continue to be punished by unaffordable mortgage payments and underwater home values. Laurie Goodman, a mortgage analyst at Amherst Securities Group, said in an Oct. 1 report that if government doesn't step up its intervention, over 11 million borrowers are in danger of losing their homes. That's one in five people with a mortgage. "Politically," she wrote, "this cannot happen. The government will attempt successive modification plans until something works."

Wall Street's unspoken strategy has been to kick mortgage losses down the road until an economic recovery reinflates the housing market. The faulty-foreclosure crisis has forced the issue back into the present tense, triggering a fight over who will bear the brunt of those losses. The combatants—all of whom are trying to minimize their share of the damage—include homeowners, lenders and mortgage brokers, loan servicers and the underwriters of mortgage-backed securities, the buyers of those securities, title insurers, rating firms, and the federally controlled mortgage buyers Fannie Mae and Freddie Mac. J.P. Morgan predicts that bondholders will absorb most of the estimated $1.1 trillion loss—but may succeed in foisting about $55 billion on banks. If the bank losses turn out to be steeper than J.P. Morgan and most other analysts expect, taxpayers may be asked to inject more capital into the financial institutions. Fannie Mae and Freddie Mac, already wards of the state, might require more capital as well.

The last five years of rising foreclosures, to the highest rate since the Great Depression, have exposed the carelessness with which banks lent money. The banks figured they could always seize ownership and resell at a profit, assuming they hadn't already dumped the loan on an unwary investor. And they wouldn't let technicalities impede the process; the website 4closurefraud.com, which is operated by the Carol C. Asbury Save My Home Law Group, has links to documents from Nassau County, N.Y., in which someone entered "BOGUS" as the grantee for the

Who Owns Your Home?



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mortgage–i.e., the party entitled to foreclose.

During the housing boom, transactions were flowing so fast that banks couldn't keep up with the paperwork. The mortgage industry depended on a digital overlay of its own invention, Mortgage Electronic Registration Systems, a database owned by Fannie Mae, Freddie Mac, Bank of America, CitiMortgage, Chase Home Mortgage, Wells Fargo, and others, including title insurers. No matter who bought the loan, MERS was purported to be the mortgagee–i.e., the party that would foreclose if a borrower stopped paying. Ridiculous? Of all newly issued U.S. mortgages, 60 percent list MERS–a unit of Reston (Va.)-based MERSCorp that has no employees of its own–as the mortgagee. "It's a total attack on the public system," says Christopher L. Peterson, a law professor at the University of Utah who has consulted in cases against MERS.

As MERS sped up loan processing, it created a giant legal hairball. According to Peterson, state judges in Kansas, Arkansas, and Maine have said that MERS has no standing in foreclosure proceedings under their states' laws if they can't produce the promissory note. In early October a federal judge in Oregon blocked Bank of America as trustee from foreclosing on a home in the MERS system. (MERS spokeswoman Karmela Lejarde says its standing has always been upheld, "either in the initial court proceeding or upon appeal.") Judges also resent that would-be foreclosers show up in court representing themselves as vice-presidents of MERS even though they work for various loan servicers. Fixing the paperwork won't be easy because many of the notes have been lost or even deliberately shredded. The Florida Bankers Assn. told the state Supreme Court last year that in many cases "the physical document was deliberately eliminated to avoid confusion immediately upon its conversion to an electronic file."

As staggering as the projected stakes are in the housing crisis, at least you can put a number on them. What's incalculable is the psychic cost of a legal system that may well have let banks skirt the law. "The whole financial system is becoming a lot less transparent," says Hernando de Soto, a Peruvian economist who has written on the importance of well-defined property rights. "You can't size up risk anymore."

"We are killing our competition!" says Greg Whitworth. It's a perfect October day on the Jacksonville, Fla., campus of Lender Processing Services (LPS), and Whitworth, a division president, is rallying a crowd of 200 employees inside a big white tent on the sun-drenched banks of the St. Johns River. The company is celebrating what it calls "the Year of the Megas"–key customers Bank of America, Wells Fargo, and JPMorgan Chase–with a picnic of Mediterranean chicken salad, lemon cooler cookies, and sweet tea.

LPS is America's biggest mortgage-and-foreclosure outsourcing firm. Last year its revenue from default services climbed to $1.1 billion; its nearest rival, Santa Ana (Calif.)-based CoreLogic, takes in less than half of that.

One gray patch hovers over the celebration: The back-office technology provider's runaway success means it is tangled up in the foreclosure crisis. "I was thinking about the dark clouds over the company," Joe Nackashi, the chief information officer, tells the crowd.



A records room at the Washington County Courthouse in Jonesborough, Tenn. As the market boomed, the mortgage industry moved to a digital system that some judges say lacked legal authority

DAVE BOYD/JOHNSON CITY PRESS/AP PHOTO



"Sure, we have made mistakes. But I don't want to let that cloud this day."

LPS supplies much of the digital plumbing for the convoluted home-finance system. At the start of 2010 it said its computer programs were handling 28 million loans with a total principal balance of more than $4.7 trillion—or more than half the nation's outstanding mortgage balances. With 8,900 employees and total revenue of $2.4 billion, it sells software and manpower to most of the largest U.S. lenders and loan servicers. "The banks were not prepared for this volume of foreclosures, and that has played to the company's advantage as the outsourcer," says Brett Horn, associate director of equity research at Morningstar.

Consider for a moment the mountains of paper that a buyer signs at closing. The industry uses LPS computer programs and sometimes LPS employees to code, store, and transfer many of these records. When things work smoothly, mortgage servicers rely on LPS software to help monitor payments. When homeowners fall behind, LPS helps assemble the information needed to foreclose.

The business has a fast metabolism; as described in an in-house newsletter published in September 2006 by Fidelity National Foreclosure Solutions, a predecessor of LPS, a single 18-person "document execution" team brings Henry Ford's mass-production techniques to the foreclosure business. "The document execution team is set up like a production line, ensuring that each document request is resolved within 24 hours," the newsletter said. "On average, the team will execute 1,000 documents per day." That was four years ago, when the foreclosure rate was a quarter what it is now.

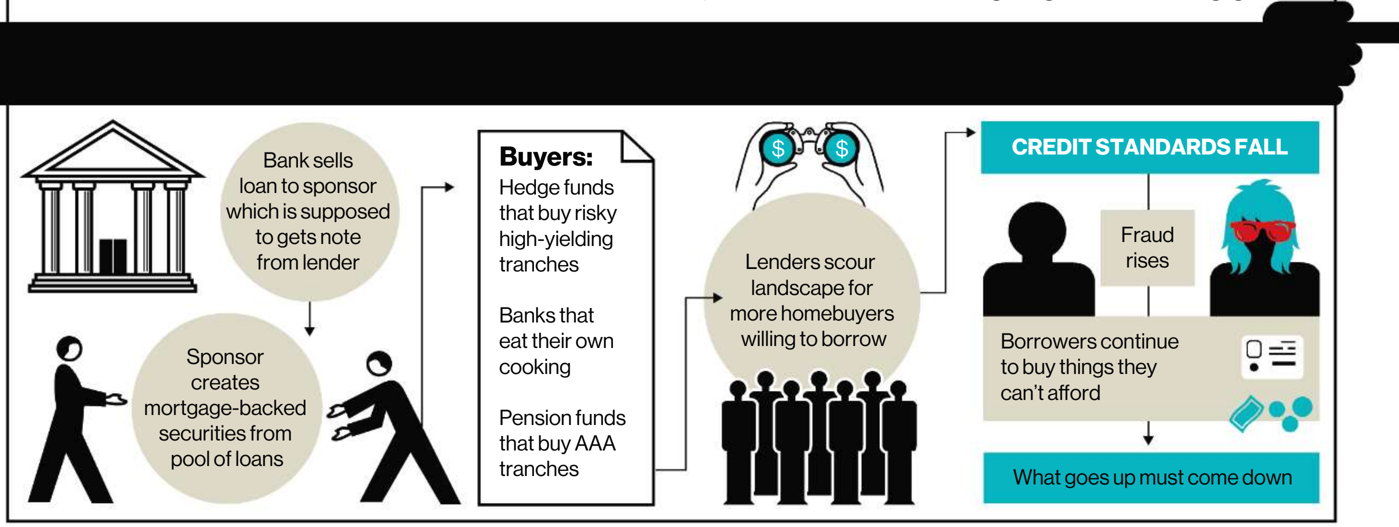


It was when some of those documents proved difficult to track down that trouble set in. If a foreclosure lawyer working on behalf of a bank or servicer asked LPS for an errant mortgage, for example, some company workers may have gone to extremes to keep the foreclosure assembly line moving, according to prosecutors and plaintiffs' lawyers. The Florida attorney general's office has alleged that in some cases, corners may have been cut, signatures forged, documents backdated. Industry employees have said in sworn depositions that "robo-signers" executed paperwork without reviewing it.

The U.S. Attorney's Office in Tampa and the state of Florida are investigating whether LPS and affiliated companies have fabricated documents and faked signatures. LPS employees "seem to be creating and manufacturing 'bogus assignments' of mortgage in order that foreclosures may go through more quickly and efficiently," the Florida Attorney General's Office says in an online description of its civil investigation. "We're concerned that people might be put out of their houses unfairly and unjustly," Bill McCollum, the attorney general, told *Bloomberg Businessweek*. In a third investigation, the U.S. Trustee Program, the branch of the Justice Dept. that polices bankruptcies, is looking into whether LPS is "improperly directing legal action" to hasten foreclosures, according to a 2009 opinion issued by the bankruptcy court in Philadelphia. A Trustee spokeswoman declined to comment.

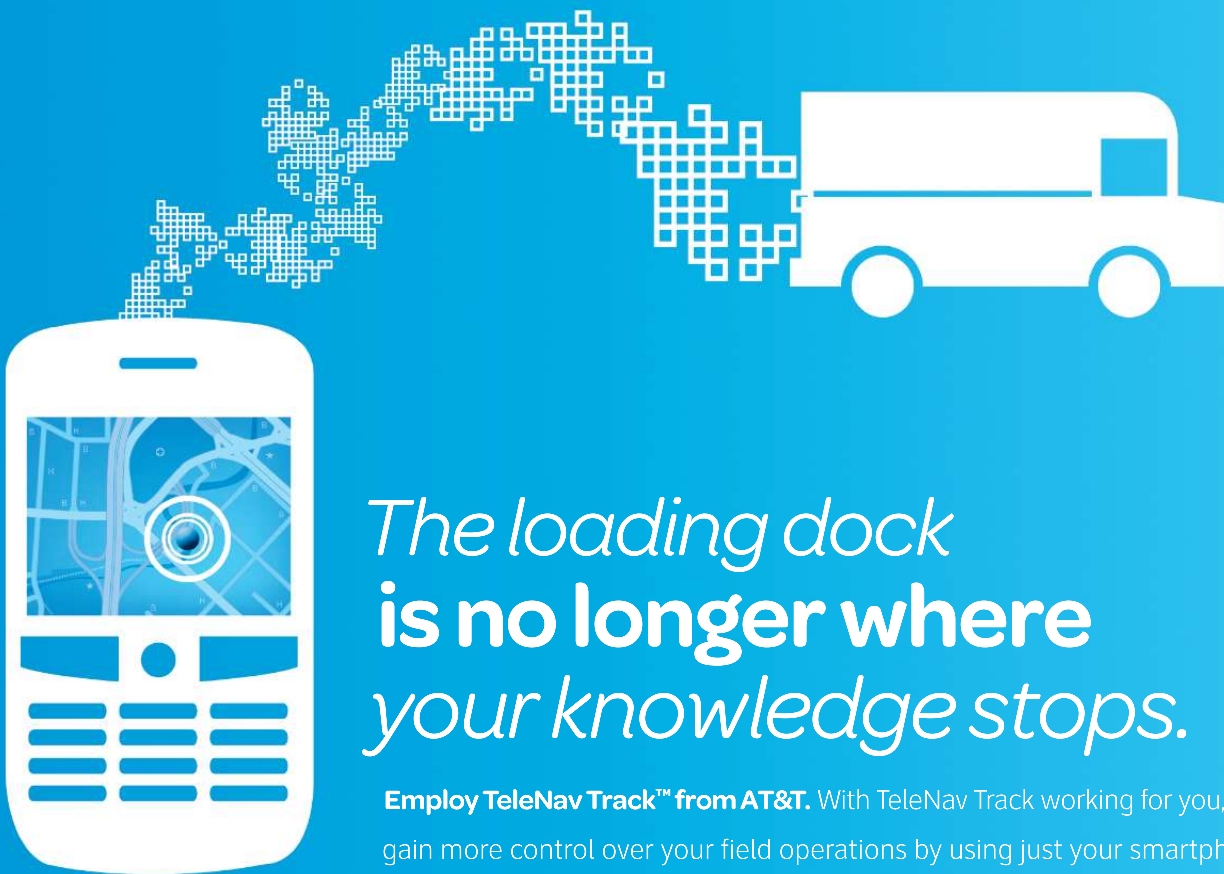
On Sept. 29, U.S. Representative Alan Grayson (D-Fla.) denounced LPS on the House floor. "The system is so organized that there is a company, Lender Processing Services, who allegedly has created the means to systemize fraud," he said. Foreclosure-defense lawyers have filed suit against LPS in Mississippi and Kentucky, seeking class-action status and accusing the company of improperly splitting fees with pro-foreclosure lawyers. LPS shares have fallen sharply on the New York Stock Exchange and as of Oct. 20 were down 33 percent for the year.

LPS executives acknowledge slip-ups, but nothing amounting to fraud. In a federal securities filing in February, the company said it had "identified a business process that caused an error in the notarization of certain documents, some of which were used in foreclosure proceedings." LPS says it fixed the problem and closed the subsidiary in Georgia where it occurred. As for the processing team described in the in-house newsletter, LPS spokeswoman Michelle Kersch says the company decided such affidavit-execution services were "not an appropriate use of resources," and ended them in September 2008. Still, she adds, LPS "signs a limited number of documents for clients," including assignments of mortgage.



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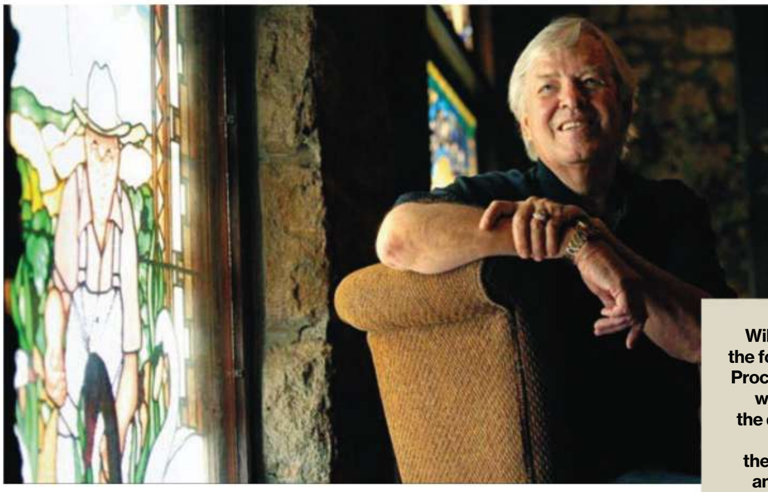
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William P. Foley II, the founder of Lender Processing Services, which provides the digital plumbing for much of the U.S. mortgage and foreclosure industry. He earned $45.9 million last year

CHRISTOPHER CHUNG/THE PRESS DEMOCRAT, SANTA ROSA, CA

"We are dealing with sensationalism vs. facts," Jeffrey S. Carbiener, the company's chief executive officer, told analysts in an Oct. 6 conference call. "Isolated instances of errors" are bound to occur, but they "are now being brought out and pointed back to that robo-signing, making it sound like a large percentage of these transactions are invalid. That is just simply not the case." He called the class-action suits "fishing expeditions."

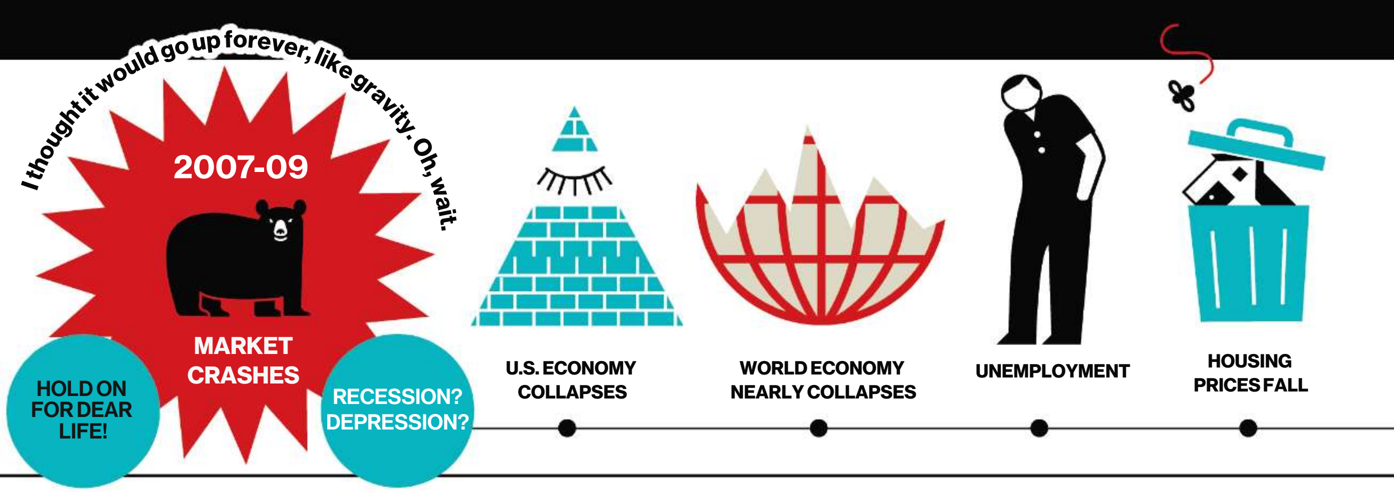
To keep the paperwork moving, LPS uses a variety of incentives. Top-performing workers receive monthly "Drive for Pride" awards that sometimes include $500 in company stock and a spot in an underground parking garage. LPS also devised a coding system to grade outside foreclosure attorneys based on their speed in completing tasks. Fast-acting attorneys receive green ratings; slower lawyers are labeled yellow or red and may receive fewer assignments. "Bill will move quickly and expect you to be there to pull your weight," says Jerry Mallot, executive vice-president of the Jacksonville Regional Chamber of Commerce. "I wouldn't call the environment at his company kind and genteel."

Bill is William P. Foley II, a 65-year-old West Point graduate, real estate lawyer, and wealthy vintner. He made a fortune assembling the country's largest title-insurance company, beginning with his purchase in 1984 of Fidelity National Title. By 2003, Fidelity National, then based in Santa Barbara, Calif., had $10 billion in annual revenue and 32 percent of the U.S. title-insurance market. Frustrated by the high cost of operating in California, Foley was convinced by Mallot and then-Florida Governor Jeb Bush, an occasional golfing companion, to relocate to Jacksonville. A spokeswoman said Foley, who left the LPS board last year, wasn't available to comment.

Spun off in 2008, LPS is one of the city's largest employers, with 2,400 local workers. Its headquarters is in a 12-story office building on palm-lined Riverside Avenue, part of a complex that also houses Fidelity National Financial, the original title insurer, and Fidelity National Information Services, a 2006 spin-off now called FIS.

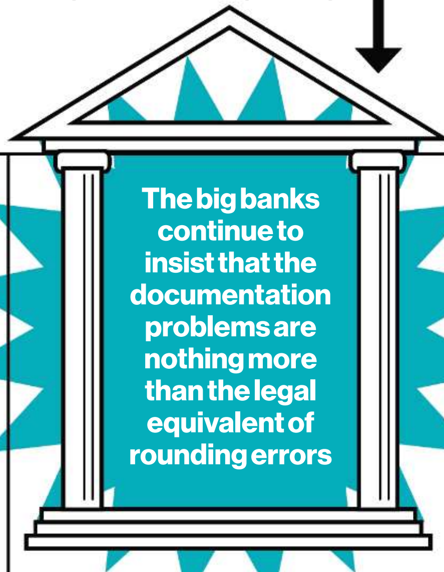
Foley and his wife, Carol, split time between a home in Jacksonville's Ponte Vedra Beach, a ranch in Whitefish, Mont., and California, where Foley owns seven wineries. His compensation last year from LPS and the Fidelity National companies was $45.9 million, according to company filings.

The growth of LPS and other foreclosure outsourcing has dismayed even some professionals deeply involved in the process. Judge Diane Weiss Sigmund of the U.S. Bankruptcy Court in Philadelphia last year published an unusual 58-page opinion scrutinizing LPS because, she said, she wished "to share my education" with others in the system "who may be similarly unfamiliar with the extent that a third-party intermediary drives the Chapter 13 process." Her opinion described an attempt by the multinational bank HSBC to foreclose on the home of Niles and Angela Taylor, who had filed for bankruptcy protection from their creditors. Judge Sigmund ruled the bank's outside attorneys mistakenly tried to take the Taylors' home because of three disputed flood-insurance payments totaling $540. She blamed lawyer



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incompetence, exacerbated by a "slavish adherence" to an LPS computer system called NewTrak.

What bothered the judge, she wrote, was the way HSBC and its lawyers entrusted "the NewTrak system [with] the management of its defaulted loans in bankruptcy. ... With the HSBC data uploaded to an LPS system, LPS responds to the perceived needs of retained counsel. ... The retained counsel does not address the client directly." Overreliance on LPS contributed to six months of unnecessary hearings, the judge wrote. After she ordered the parties to settle the issue in person, they did so in just an hour. HSBC acknowledged that the property did not require flood insurance after all, and the truce cleared the way for resolution of the Taylors' bankruptcy plan.

Judge Sigmund, who has since retired, scolded one of HSBC's outside lawyers for being too "enmeshed in the assembly line" of managing foreclosures and ordered her to take extra ethics training. The judge instructed HSBC to remind all of its lawyers in writing not to defer excessively to computerized data systems. LPS, the judge added, did not deserve punishment because the outsourcer had merely provided tools that others misused.

McCollum, the Florida AG, suspects that in other cases LPS is more than an innocent facilitator. In April, he says, "a homeowner contacted us," alleging that LPS paperwork had been "forged in some way." His office opened a civil investigation. While McCollum, a Republican, would not provide specifics, subpoenas his office issued on Oct. 13 demand information on six employees of an LPS subsidiary called Docx. The attorney general's office is investigating whether the employees had the authority to execute mortgage documents for lenders and servicers. One employee, Linda Green, at various times identified herself as a vice-president or representative of more than a dozen different banks and mortgage companies, according to the subpoena. "Docx has produced numerous documents, called assignments of mortgage, that even to the untrained eye appear to be forged and/or fabricated as the signatures of the same individual vary wildly from document to document," the AG's office says on its website.

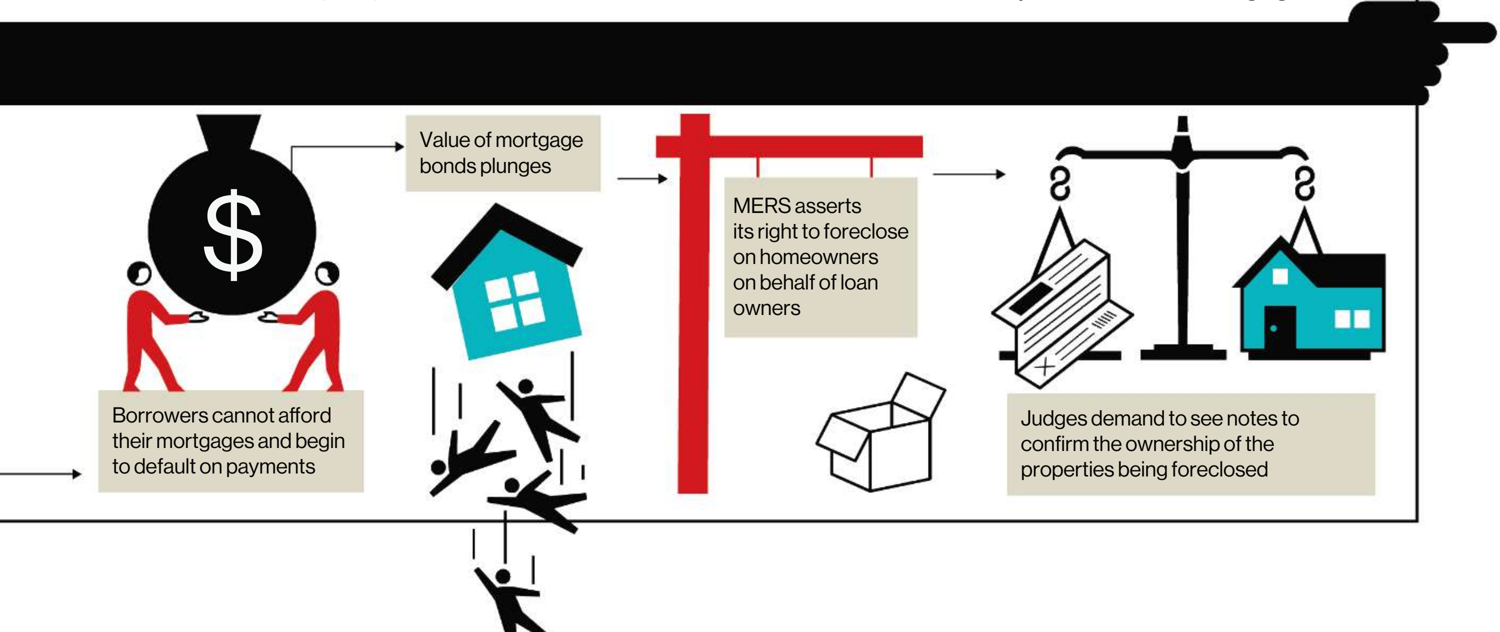
LPS disclosed in February that the Tampa U.S. Attorney's Office is "reviewing the business processes" of the Docx unit. April Charney, a senior attorney with Jacksonville Area Legal Aid and an outspoken critic of LPS, says she was contacted by a federal prosecutor about the company earlier this year. The prosecutor informed her in April, she adds, that the Justice Dept. was seeking depositions from LPS and Docx employees.

LPS says it shut the Docx unit in April and is cooperating with investigators. "We feel like we have taken all appropriate corrective actions," Carbiener, the CEO, told analysts on Oct. 6. "We don't feel like this is going to have or will have a material impact on our financial results."

Quite the contrary, he added, the foreclosure chaos could be good for business. Dogged by foreclosure-defense attorneys and government investigations, lenders and servicers will have to retrace their steps. "Those services that we provided initially we'll provide again," Carbiener said. "For those loans that are held in review, we have the opportunity to earn additional revenues."

The big banks continue to insist that documentation problems are the legal equivalent of rounding errors. On Oct. 18, Bank of America, which suspended foreclosures in all 50 states, played down that suspension and said it would resubmit foreclosure affidavits in 23 states after completing a speedy review of 102,000 files. Citigroup said its foreclosure process was "sound." JPMorgan Chase Chief Executive Officer Jamie Dimon told investors on Oct. 13, "If you're talking about three or four weeks, it will be a blip in the housing market." He added, "If it went on for a long period of time, it will have a lot of consequences, most of which will be adverse on everybody."

The "blip" scenario may be too rosy. Ohio Attorney General Richard Cordray on Oct. 19 expressed deep skepticism that Bank of America had managed to complete its internal review in just 2½ weeks, saying, "I would caution that they still have significant financial exposure in many, many cases." Even if the homeowners deserve to be foreclosed on, paperwork problems could stand in the way. Mark J. Grant, a managing direc-



tor for structured finance at Dallas-based Southwest Securities, wrote on Oct. 18 that what may lie ahead is a “Whangdepootenawah,” a word from Ambrose Bierce’s *Devil’s Dictionary* (“disaster; an unexpected affliction that strikes hard”). Wrote Grant: “I doubt that you have followed the contagion down the path to the end because if you had, if anyone had … there would be a lot more retching in the streets and on Wall Street’s trading desks.”

Even if the I.O.U.s can be straightened out quickly, the fighting won’t stop. Quoting unnamed sources, *The Washington Post* reported on Oct. 19 that the Obama Administration’s Financial Fraud Enforcement Task Force is investigating whether financial firms committed federal crimes in filing fraudulent court documents to seize people’s homes.

Meanwhile, a high-stakes fight is breaking out between the banks that made loans and the investors who bought them. A shot was fired on Oct. 18 when a group of major investors claimed that Bank of America’s Countrywide Home Loan Servicing had failed to live up to its contracts on some of more than $47 billion worth of Countrywide-issued mortgage bonds. The group said Countrywide Servicing has 60 days to correct the alleged violations, such as failure to sell back ineligible loans to the lenders. According to people familiar with the matter, the group includes Pimco, BlackRock, and the Federal Reserve Bank of New York.

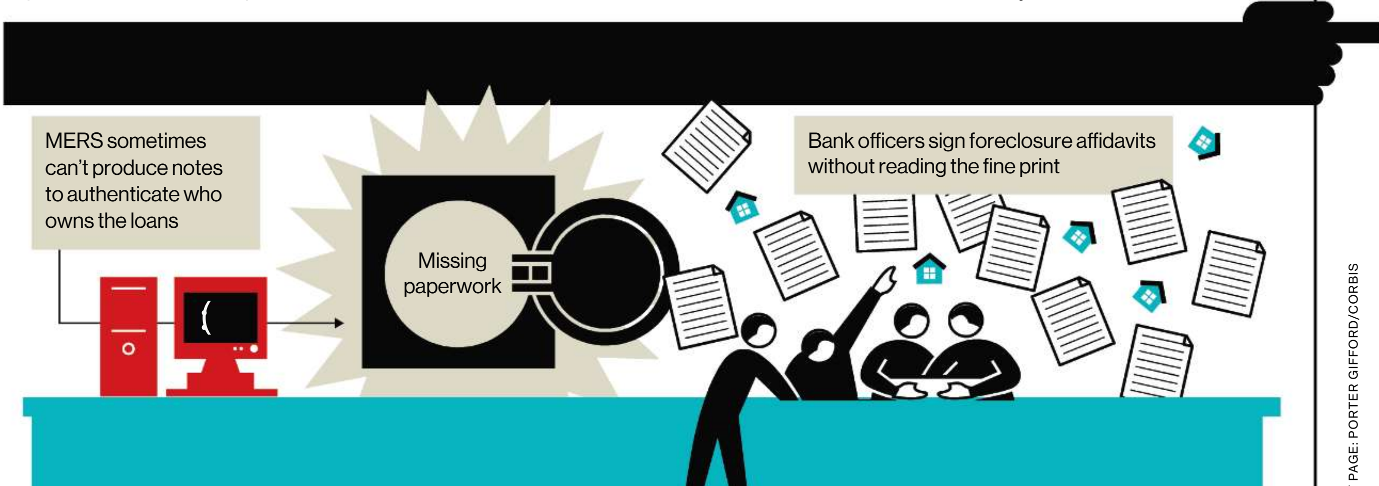
For banks that have just started making money again after near-death experiences in 2008, mortgage losses could delay the return to good health. Chris Gamaitoni, an analyst for Compass Point Research & Trading, a Washington financial advisory firm, estimates losses for the big banks of $134 billion from having to buy back bad loans from private investors and another $27 billion in losses from buying back loans from Fannie Mae and Freddie Mac. Other estimates are lower—from $20 billion to $84 billion—in part because those analysts are less certain than Gamaitoni that investors will succeed in court.

If Freddie Mac did not back off its requests for buybacks, Bank of America officials said, the bank would take its new mortgages to Fannie Mae

Bank of America, the nation’s largest lender, has resorted to tough tactics in resisting repurchases of bad loans. Facing pressure from Freddie Mac, one of the two government-controlled mortgage financing companies, to buy back money-losing home loans with problems like inflated appraisals, overstated borrower income, or inadequate documentation, Bank of America issued a blunt threat, according to two people with direct knowledge of the incident. If Freddie Mac did not back off its demands for the buybacks, Bank of America officials said, the bank would take more of the new, more profitable mortgages it is originating these days to rival Fannie Mae, these people said. Freddie and Fannie, known as GSEs (government-sponsored entities), need a steady supply of healthy new loans to climb out of their financial hole.

The claimed threat from Bank of America, which was not put into writing, according to one of these people, was taken seriously enough that it has been discussed at several Freddie Mac board meetings, including one in mid-October. Some officials have urged the Federal Housing Finance Agency—the government conservator that has controlled Fannie and Freddie since they were bailed out in 2008—to confront Bank of America and prevent it from trying to play one against the other, which may be infuriating but is not illegal. “If the tactic worked, I’d be shocked and appalled,” said Thomas Lawler, a former portfolio manager at Fannie Mae and now an economic consultant. “The GSEs are supposed to be run now to minimize losses to the taxpayers. Freddie ought to ignore the threat.” FHFA Acting Director Edward J. DeMarco declined to comment, as did officials of Freddie Mac. Bank of America also declined to comment.

For policymakers, the dilemma is this: Enormous losses will cause problems wherever they end up. They could further harm Fannie and Freddie, which insure the vast majority of the nation’s mortgages and have already received nearly $150 billion in taxpayer support. Or, if Fannie and Freddie succeed in pushing the burden back to the banks, the losses could cripple some of the major institutions that have just emerged from a government bailout. Bank of America faces $12.9 billion in buyback requests, and mortgage insurers have asked for the documents on an additional $9.8 billion on which they may consider seeking repurchases, according to regulatory filings. (Bank of America has put aside $4.4 billion for buybacks, and CEO Brian



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T. Moynihan says the costs will be manageable.) "The Treasury is very aware that they can't push too hard on this because if you do push too hard it might put the companies in negative capital again," says Paul J. Miller, an analyst at FRB Capital Markets. "There's a lot of regulatory forbearance going on."

Aside from ignoring banks' bad debts, Washington hasn't done much to fix the crisis. Both houses of Congress easily passed a bill this year that would have undermined centuries of law by requiring every state to recognize MERS-type electronic records from other states. Only a pocket veto by President Barack Obama kept it from becoming law.

One option, opposed by the Obama Administration and most Republicans in Congress but favored by Senate Majority Leader Harry Reid and others, is a national moratorium on foreclosures. It would last until regulators assure themselves that lenders have straightened out their foreclosure procedures. Opponents say it would delay the recovery of the housing market by preventing qualified buyers from getting their hands on foreclosed homes. Supporters of the idea, such as Dean Baker, co-director of the Center for Economic and Policy Research, say there are plenty of already foreclosed homes available for sale and thus no urgent need to add to the supply.

Goodman, the Amherst Securities analyst, says banks need to reduce the principal that people owe on their homes so they have an incentive not to walk away. "Ignoring the fact that the borrower can and will default when it is his/her most economical solution is an expensive case of denial," Goodman writes. If the home whose mortgage was reduced happens to regain value, 50 percent of the appreciation would be taxed, she says. Meanwhile, to discourage people from sitting tight in homes while foreclosure proceedings drag on, she would have the government tax the benefit of living in the home rent-free.

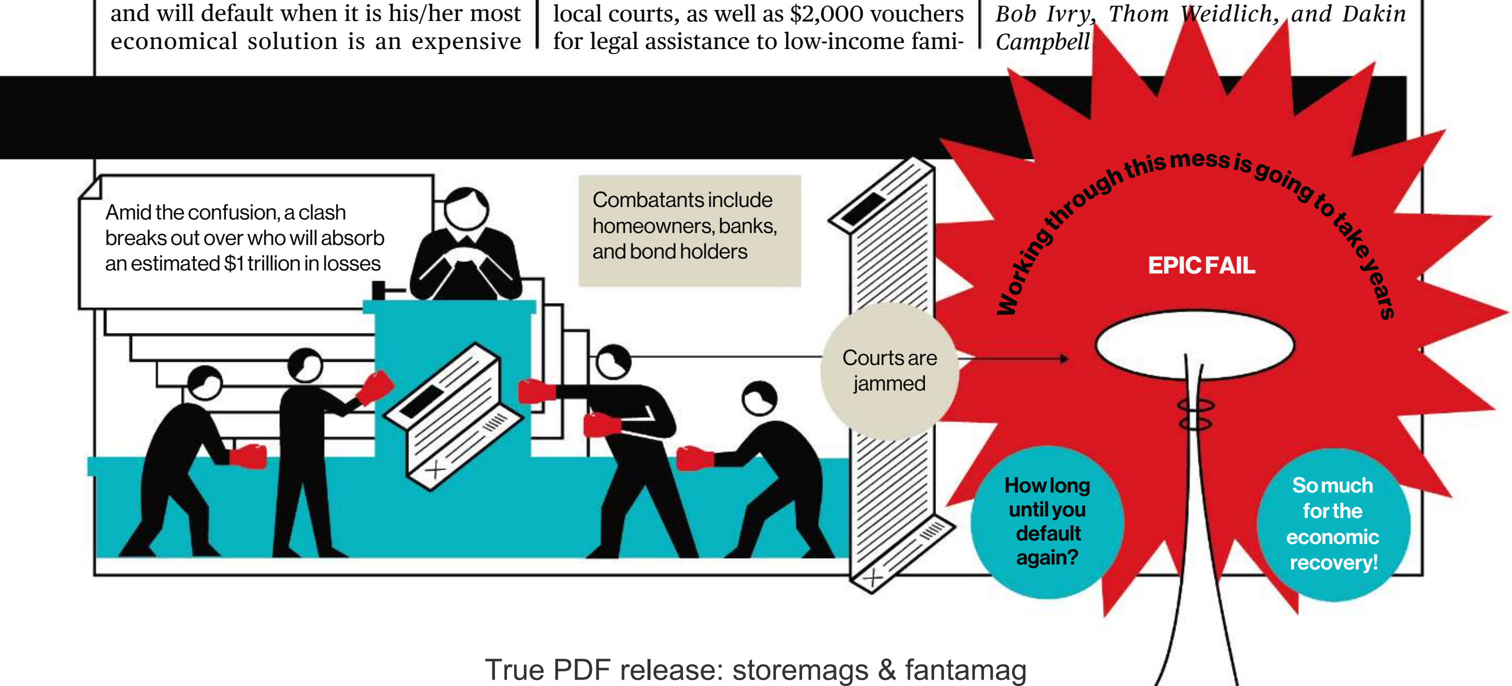
CitiMortgage is testing an innovative alternative based on the legal procedure known as "deed in lieu of foreclosure." The owner turns the deed over to the bank without a fight if the bank promises not to foreclose, lets the family stay in the house after the agreement for six months, and gives relocation assistance.

Other ideas: In a *New York Times* blog post on Oct. 19, Harvard University economist Edward Glaeser suggested federal assistance to overwhelmed state and local courts, as well as $2,000 vouchers for legal assistance to low-income families that can't afford to fight foreclosures. Bloomberg News columnist Kevin Hassett, who is director of economic policy studies at the American Enterprise Institute, says in his Oct. 18 column that the newly created Financial Stability Oversight Council should make the foreclosure mess its first big project, "take authority for solving it, and do so as swiftly as possible."

Speed is essential. The longer it drags on, the more the foreclosure crisis corrodes Americans' faith in their financial and legal systems. A pervasive sense of injustice is bad for the economy and democracy as well. Take Joe Lents. The Boca Raton homeowner hasn't made a mortgage payment since 2002, but he perceives himself as a victim. "I want to expose these guys for what they're doing," Lents says. "It's personal now." B *–With James Sterngold, Jody Shenn, Bob Ivry, Thom Weidlich, and Dakin Campbell*



Foreclosed houses in Boston. The much-reported foreclosure "suspension" by the big banks slowed bank repossessions by all of 3 percent through Oct. 18, according to RealtyTrac.com.



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Meet the Chinese tilapia, a bland food product that grows fast and sells cheap. Environmentalists hate it, but Americans keep ordering more.

By Bruce Einhorn

Photograph by Jamie Chung

Mango-licious Tilapia

Macadamia Nut-Crusted Tilapia

At the end of a wooden pier, a squat red machine the size of a dishwasher hums along with the din of nearby cicadas. The fish-feeder is tossing grain pellets into one of Chen Haiping's nine fish ponds, each as long as a football field, in the town of Shuixi, in China's Guangdong province. It's breakfast time, and thousands of tilapia are thrashing their tails and sticking their mouths into the air to get some of the soy-and-corn mixture. Chen, a 32-year-old former duck farmer with a wispy mustache, has been running this farm for eight years.

Before the tilapia, these ponds were filled with shrimp, which the Chinese like. They aren't big fans of tilapia, a foreign fish; the name in Chinese, *luofeiyu*, refers to tilapia's origins in Africa. It doesn't have much flavor, and it doesn't grow big enough to put in the middle of the table at a family meal. Americans, however, can't get enough of Chinese-raised tilapia, so tilapia it is. The fish, Chen notes, are hardier and don't require as much work. "Shrimp can die much more easily," says Chen, who wears a wide-brimmed straw hat to protect himself from the 95-degree heat.

Despite environmental warnings about Chinese-raised tilapia from watchdog groups such as the Monterey Bay Aquarium's Seafood Watch, which publishes an influential best choices/avoid list of seafood and rates Chinese-raised tilapia as "avoid," U.S. consumption keeps rising. In 2009 the U.S. imported 404 million pounds of tilapia, up from 298 million in 2005. Wal-Mart Stores imports nearly 200 shipping containers, or 8.8 million pounds, every month, although they will not say how much comes from China. (The company declined to comment.) Domestic fish farmers can't come close to meeting demand. Although there are tilapia farms in the U.S., the fish does better in tropical climates, so most of it comes from Asia or Latin America.

As overfishing threatens the world's wild fisheries, aquaculture advocates say fish farms will play a far greater role in feeding people around the world. "We are no more going to get our seafood from the wild than we get our beef, nuts, fruit from the wild," predicts Kevin Fitzsimmons, a professor at the University of Arizona and former president of the World Aquaculture Society. He is also on the board of HQ Sustainable Maritime Industries, an NYSE Amex-listed company that sells Chinese-raised tilapia. "It's all going to be farm-raised," he says. And there's no fish better suited to this new world than tilapia, says Fitzsimmons. It's a fast-growing species with mild-tasting flesh that producers can easily adapt to all kinds of uses. "Tilapia," says Fitzsimmons, "is going to be basically where chicken is with poultry."

That means that the creatures thrashing in Chen's ponds are the future of fish. The growing American appetite has led to a boom in Chinese aquaculture: With hundreds of breeding centers, fish farms, feed mills, and processing plants, China is the world's tilapia superpower. That's why I've traveled to the heart of the Chinese aquaculture industry, in southern Guangdong and the nearby island province of Hainan, to see how farmed-in-China fish make their way to the American table.

For a tilapia, Chen's farm is a pleasant enough place to grow up. The farm is about an hour and a half's drive on potholed roads from Zhanjiang, the closest big city in this part of Guangdong. The province—home to huge factories owned by companies like Taiwan's Foxconn that employ hundreds of thousands of workers and produce iPhones and other products for export—is one of the most polluted areas in one of the world's most polluted countries. Smog regularly fouls the air and chemicals poison the water in the boomtowns of the Pearl River Delta, near Guangdong's border with Hong Kong. Those factories, however, haven't yet made it to the southwest of Guangdong, an area 200 miles away that is still a green oasis of banana trees, rice paddies, and sugarcane farms.

Tilapia from China can be found in Wal-Mart's freezers. Its two ingredients: "Tilapia" and "Carbon Monoxide (To Retain Natural Color)"

The conditions on the fish farms are surprisingly clean. Because tilapia—unlike farmed salmon—grow quickly, they don't need big supplies of antibiotics to keep them healthy. Western media sometimes report on the filthy, algae-filled ponds of Chinese aquaculture. It's true for many mainland farms, especially those raising eel. Tilapia, though, have meat that easily takes on the flavor of whatever the fish happen to have consumed, and tilapia that swim in muddy, algae-filled waters end up with a musty flesh that American consumers hate. Before accepting tilapia from Chinese farms, buyers will check to make sure the fish don't have that pondy flavor. To avoid rejections, Chen and other farmers say, they keep their ponds clear of material that could ruin the tilapia's taste.

Doing so requires a lot of water, but Chen doesn't have to worry about paying for it. He takes his water from a nearby canal maintained by the local government, part of a policy to promote the growth of aquaculture through tax breaks and other subsidies. For farmers like Chen, it's a good deal. "The water," he says, "is free."

With the hot weather, frequent feedings, and fresh water, fish destined for dinner in the U.S. need just a few months to grow to a harvestable size of 1 to 2 pounds. Soon a handful of Chen's workers will be standing up to their armpits in the water, dragging nets across the ponds and forcing the tilapia all into one end. They'll grab the fish by hand and throw them into buckets onshore. Other workers will dump the containers into a large truck that can carry as many as 10,000 live fish. Then the truck will head off to a processing plant, where the fish will become food.

There's no shortage of facilities nearby to do the killing. In one sign of how quickly the industry has taken off, there are 268 factories in the Zhanjiang area that can kill, skin, and freeze tilapia, according to the local aquatic products import and export association. That's a 33 percent increase in just three years.

A decade ago, few Americans ate tilapia. The fish didn't even make the top 10 list of consumed seafood in the U.S. until 2002, when it squeaked by with av-

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erage consumption of just 0.3 lb. a year. Then demand surged in the wake of the Atlantic cod fishery collapse. By 2009, according to data released on Sept. 7 by the National Marine Fisheries Service, Americans ate 1.2 pounds of tilapia. That put the fish well ahead of cod and catfish and just behind pollock as the most popular white fish in the U.S. (Shrimp is the top seafood, at 4.1 pounds consumed per American, and canned tuna the top fish, at 2.5 pounds.)

It's not that tilapia is particularly tasty; it simply takes on the flavor of other ingredients. "It has got nothing going for it," says Colin Freeman, a consultant for Pristine Oyster Farm in South Australia. A few weeks before I travel to Chen's farm in Hainan, I'm visiting relatives in Brookline, Mass., near Boston, and stop by Wulf's Fish Market, a shop on Harvard Street not far from JFK's birthplace. The store doesn't carry tilapia, an annoyed employee tells me, even though people often ask for it. "Tilapia," he snarls, "is the tofu of fish."

Unlike salmon, tuna, and other big ocean fish, tilapia's flesh doesn't contain omega-3 oils, one of the main health benefits of seafood. But because it is cheap and easily raised on farms, it has created an opening for China. Just as Chinese factories are the go-to source for inexpensive toys, electronics, and clothes, the country's aquaculture industry has quickly come to dominate production of cheap, mass-produced fish. According to the U.S. Commerce Dept., about 80 percent of the frozen tilapia in the U.S. is now imported from China, with restaurants and supermarkets the biggest buyers. Tilapia demand "has grown at a phenomenal rate," says Keith Decker, president and chief operating officer of High Liner Foods USA, the Danvers (Mass.) subsidiary of the Nova Scotia-based producer of fresh and frozen seafood. The company is a big importer of cod and haddock, and is now a major buyer of tilapia, which it sells wholesale as well as under its Sea Cuisine brand. The company's products include over 50 types of tilapia meals such as Lemon Pepper Tilapia and Coconut Crusted Tilapia.

Tilapia is especially well-suited to American tastes. "Tilapia fulfills a need for a large portion of the population that doesn't like their fish tasting 'fishy,'" says chef Rick Moonen, owner of Rick Moonen's RM seafood restaurant at the Mandalay Bay hotel in Las Vegas and author of the 2008 cookbook *Fish Without a Doubt*. Pollock remains slightly more popular, as measured by per-capita consumption. That's misleading, though, since pollock caught off the coast of Alaska is ground up by McDonald's and other fast-food chains and turned into fish sandwiches and nuggets; few people go to their local supermarket or Ruby Tuesday looking to have pollock for dinner. Tilapia has gained in popularity because one fillet by itself can be a main course. It's what Decker and others in the fish business call a "center-of-the-plate" fish. "Tilapia," Decker says, "has a huge future."

Given the record of products made in China—milk tainted with melamine, toys with lead, toothpaste with the poisonous chemical diethylene glycol—many

i One of Chen Haiping's nine ponds and the machine that feeds the fish



i Guangdong Evergreen's fish-processing plant near Zhanjiang



Americans may not welcome that future. The U.S. imported $5.2 billion worth of food from China in 2008, with aquaculture products accounting for 41 percent. A report last year from the U.S. Agriculture Dept.'s Economic Research Service called into question Chinese safety standards for farm-raised fish and seafood. "Fish are often raised in ponds where they feed on waste from poultry and livestock," the report said. Meanwhile, environmentalists are concerned about the impact of China's fish farms, as water filled with tilapia feces is flushed from the ponds. They also worry about the invasive nature of the species in the U.S. (Last year in Louisiana's Plaquemines Parish, for example, officials used poison to kill off tilapia in the area's canals and ditches.) "In theory there is quite a lot of regulation in place," says Pete Bridson, aquaculture research manager at the Seafood Watch program in Monterey, who traveled to China last year to visit tilapia farms. "But the environmental side of the regulation is not enforced very well."

A global aquaculture industry dominated by China worries Mike Picchietti, president of Regal Springs Tilapia, a company based in Bradenton, Fla., that operates tilapia farms in Indonesia, Honduras, and Mexico, and is a supplier to Costco. For instance, he says Chinese farmers save money using fish feed only when the tilapia are bigger. When they're still young, he says, farmers toss animal waste in the ponds and allow the tilapia to feed on the algae bloom that follows. "They're able to cut their feed costs because they're able to use manure," he fumes. Raised-in-China tilapia are therefore much cheaper, according to Picchietti. "The Chinese are able to use cowshit," he says, "and I can't." Chinese tilapia growers deny Picchietti's claim.

As the sun sets and people elsewhere in the city are heading home for dinner, at Guangdong Evergreen's processing plant near Zhanjiang, employees are gathered near the loading dock, preparing to start their shifts. Trucks are arriving with thousands of

Raspberry Tilapia

Blackened Tilapia with Secret Hobo Spices

freshly harvested tilapia, and the fish need to be killed and processed quickly to ensure they are as fresh as possible before going into the deep freezer. Guangdong Evergreen has made agreements with farmers to buy their harvest-ready tilapia for processing. This factory is where fish from farmer Chen Haiping's ponds will meet their maker.

For workers and visitors alike, entering the plant is no simple procedure. They must first change into a head-to-toe white suit, making sure to take off all watches, rings, and jewelry, and put on a face mask. After washing their hands thoroughly, visitors walk through a pool of disinfectant and then into the plant itself.

Inside, hundreds work in silence as fish come off the loading dock. First, workers kill each fish by jabbing it in the head with a knife. Then they leave the dead tilapia to sit so the blood drains out of its body. Next the fish go onto a conveyor belt and the process speeds up as workers swiftly fillet the fish. With their pay partially determined by the number of fish they can process in an hour, the best workers can do this with just four cuts of the knife. After dropping the head, tail, and other remains on the floor to be picked up later, the men (women work elsewhere on the line, but the cutters are almost always men) put the six- to eight-ounce fillet back on the conveyor belt. Soon, different workers skin the fillet, followed by others who trim off any leftovers. Within a few minutes, workers are readying the fish for the freezer.

Other plants follow similar procedures. At the one operated by HQ Sustainable Maritime Industries, an Evergreen rival with offices in Seattle and Hainan, the clean suits are color-coded: Visitors wear white; assembly-line workers, blue; managers, red; quality-control supervisors, yellow. On a recent visit to the factory, plant manager Wang Fusheng points to a yellow-suited officer roaming the fluorescent-lit room. "That guy is powerful," he explains. "He can stop anything right away." Before HQ's fillets go into cold storage, the fish pass through a metal detector, just in case any stray flecks of a filleting knife have made their way into the product. "Every day we account for how many knives we've given to workers," he says. "If one knife is missing, you check everything."

Executives with tilapia processors in China point to such requirements as examples of their determination to maintain product safety. Chinese government labs regularly inspect for melamine and other banned additives; some Western buyers have their own quality inspectors or rely on third-party auditors to test the fish. Given the frequent inspections by Chinese officials and Western nongovernmental organizations, HQ Sustainable Chief Executive Officer Norbert Sporns rejects accusations that Chinese tilapia is substandard. "China is the most scrutinized export market in the world," says Sporns. He's a six-foot-seven former immigration lawyer from Montreal who got involved in Chinese aquaculture in the late 1990s; his wife, HQ Chairman Wang Li, is the daughter of a former chamber of commerce chairman in Hainan. Sporns compares Chinese tilapia farms favorably to catfish farms in Louisiana, where he calls conditions "despicable." "Our standards," he says, "are way, way better."

In addition to operating processing plants, both HQ Sustainable and Guangdong Evergreen produce fish feed for farmers—and executives reject the assertion that local farmers reduce costs by feeding the fish animal waste. In the past, some Chinese may have cut corners that way, but inspectors—from the government and from independent certification bodies like the Aquaculture Certification Council, based in Crystal River, Fla.—have put an end to the practice, they say. "No one dares do that now," says Lee Shuguang, an Evergreen manager.

Critics have plenty of other concerns. Costco, for instance, won't purchase tilapia raised on Chinese farms because of concerns about mainland production standards. Its tilapia comes from Regal Springs Tilapia. (Prices vary locally, but at the Costco in Yonkers, N.Y., fillets are $5.49 a pound; the nearby Sam's Club sells its tilapia for $4.77 a pound.) "China's track record in certain areas isn't perfect," says Bill Mardon, a seafood buyer for Costco. He singles out Chinese processors' use of a glaze on frozen fillets. It contains carbon monoxide, which preserves the color of the fish and can make a fillet look fresher than it is. "Even if the fish starts to go bad, the fish will look good," says Mardon. For the consumer looking at a frozen tilapia fillet, "the first line of defense is visibility," he says. "If the carbon monoxide takes this away, it's kind of dangerous."

Concerned about carbon monoxide, Costco won't purchase tilapia raised on Chinese farms

Evergreen manager Liu Xie calls this unfair, and says the company is only responding to its customers. "Supermarkets want us to do this," he says. "It doesn't have any effect on people; it's just to preserve the color." Regulators in the U.S. and the European Union allow carbon monoxide, he adds. Liu says some fish get coated and some don't, depending on the customer's specifications. Either way, the fish then go into the freezer, set to -36C. That's cold. "If you freeze a man at minus 40 degrees," HQ plant manager Wang explains helpfully, "he will keep forever."

Chinese aquaculture officials object strongly to Seafood Watch's "avoid" recommendation. "They don't believe in aquaculture," Sporns says. "The Monterey Bay Aquarium makes money off of ocean fish." Tilapia, a small and visually nondescript omnivore, is not a fish that captures the imagination of aquarium goers. "How many tilapia do you see there?" asks Sporns. "None."

For $23.95, diners at La Hacienda de San Angel, a new restaurant at Walt Disney World, can have grilled tilapia with roasted corn, cactus leaves, and mango chutney. The entrées at Daddy Jack's New England Lobster & Chowder House in Dallas include sautéed tilapia with lemon scallion butter and stuffed tilapia with Ritz cracker crabmeat stuffing. The Olive Garden in Rockaway, N.J., offers parmesan-crusted tilapia with vegetables and angel hair pasta for $14.95.

As tilapia becomes more common on menus across the U.S., many eateries are turning to Sysco, America's largest distributor of food to restaurants, hospitals, and schools. With 400,000 customers, Houston-based Sysco has 17 percent of the $200 billion U.S. market for tilapia, and those customers want more. "In the last six years, it's been growing about 20 percent a year," says Butch Vidrine, director of seafood purchasing for Sysco. He likes the fish's versatility: "You can fry it, grill it, barbecue it; you can do everything to it."

Responding to that demand, Sysco has become a big buyer of frozen tilapia. About 95 percent of the

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Tilapia with Creamy Pumpkin Seed Vinaigrette

company's tilapia sales are frozen, says Vidrine. For years, Sysco bought frozen fish from Regal Springs farms in Indonesia and wouldn't consider buying tilapia from China. Recently, Sysco changed its policy, approving a Chinese processor this summer. Given the 30 to 50 percent lower prices of Chinese tilapia and the growing demand for the fish, Vidrine says, it's time to give China a try. "China is like the Wild West," he says. "Some will meet [standards]. Some won't."

Tilapia from China is making inroads elsewhere. In September, Whole Foods Market locations in California started carrying the Lillian's Healthy Gourmet line of prepared frozen tilapia meals made by HQ Sustainable. At the other end of the shopping spectrum, tilapia fillets from China are in the freezer sections of Wal-Mart superstores around the country, selling under the Sea Best name. The two ingredients are: "Tilapia" and "Carbon Monoxide (To Retain Natural Color)."

Although Las Vegas chef Rick Moonen is a tilapia convert, he won't sell Chinese-raised tilapia at his 17,000-square-foot restaurant—complete with raw bar, sushi bar, and three private dining rooms—at the Mandalay Bay because Seafood Watch tells him not to. "I pretty much follow their guidelines when making choices at my restaurant," says Moonen, 54.

A graduate of the Culinary Institute of America and cofounder of the three-star restaurant Molyvos in New York, Moonen used to dismiss tilapia. That's changed. *Fish Without a Doubt* includes 13 tilapia recipes. In early September, Moonen was one of five of Bravo's "Top Chef Masters" participating in a competition to create the best new dish for spectators at the U.S. Open tennis tournament; Moonen's entry was a burger-like combination of shrimp and tilapia. "I love the fish," he says. "I think it's very versatile." He serves non-Chinese tilapia at his restaurant in dishes like fish tacos.

If it is going to win over Seafood Watch and Moonen, China's aquaculture industry needs to address concerns about tilapia and the environment. The World Wildlife Fund is one of several green groups introducing new standards for tilapia farming. "You don't want to tarnish the biggest sector just because there are some bad actors," says Aaron McNevin, an aquaculture specialist at the WWF who has worked with industry executives in China and the U.S. to identify farms that try to improve their sustainability records. "Of course there are some bad actors, because China has the most producers," he says. "But there are some groups in China that have raised the bar."

The new standards might help with environmentalists, but a bigger concern for Chinese fish farmers is facing the relentless pressure for lower prices from foreign buyers. For all the popularity of Chinese-raised tilapia, a common complaint among people in the industry is the difficulty of making money selling the fish for export. This is another area where Chinese aquaculture is like Chinese manufacturing: Both are at the mercy of buyers like Wal-Mart, which demands ever-lower prices even as costs rise along the production chain. "Land costs, labor costs, raw material costs, they've all gone up 20 to 30 percent in the last three years," says Chen Dan, chairman of Guangdong Evergreen. Brokers buying fish for the U.S. market don't care, says Shen Jian, secretary general of the local aquaculture association. "The price is too low," he gripes. "It's unfair."

Chinese producers are focusing on ways to eke out more profits. Evergreen hopes to figure out how to air-freight containers of fresh tilapia to the U.S., since fresh prices are about 50 percent higher than frozen. HQ Sustainable is focusing on value-added products such as facial creams made with collagen from tilapia scales, and it may spin off on the Shanghai stock exchange the subsidiary that makes these supplements.

HQ Sustainable CEO Sporns also dreams of working with a partner to create a fish feed that contains omega-3, the healthy fish oil that tilapia lacks. "If you have tilapia meal enriched with omega-3, that makes for a healthier tilapia," he says. "Then we've got checkmate."

Back in southwestern Guangdong, farmer Chen is focusing on more short-term solutions. Taking shelter under a tree from a midday cloudburst, he puffs on his bamboo water pipe and explains how the economics of tilapia have suddenly turned against him. With China's economy booming, costs are up sharply. His rent—which was just 500 yuan ($75) per *mu* (equal to about 79 square yards)—has more than doubled. Pay for his dozen full-time workers and 15 part-timers has jumped 40 percent, to 1,500 yuan a month. Feed and electricity costs are up, too. Meanwhile, the price he can get for his fish hasn't kept pace. Last year, 10 percent of the Zhanjiang region's tilapia farmers gave up on farming the fish.

Chen has thought about giving up, too, but for now he's sticking with tilapia. He can't do anything about the increase in his fixed costs, so he is trying to make up for smaller margins with greater volume. To do that, Chen has made his ponds deeper, making room for 20 percent more fish. "We can grow bigger fish," he says hopefully. "And more fish." B

Two of the hundreds of million of pounds imported by the U.S. annually

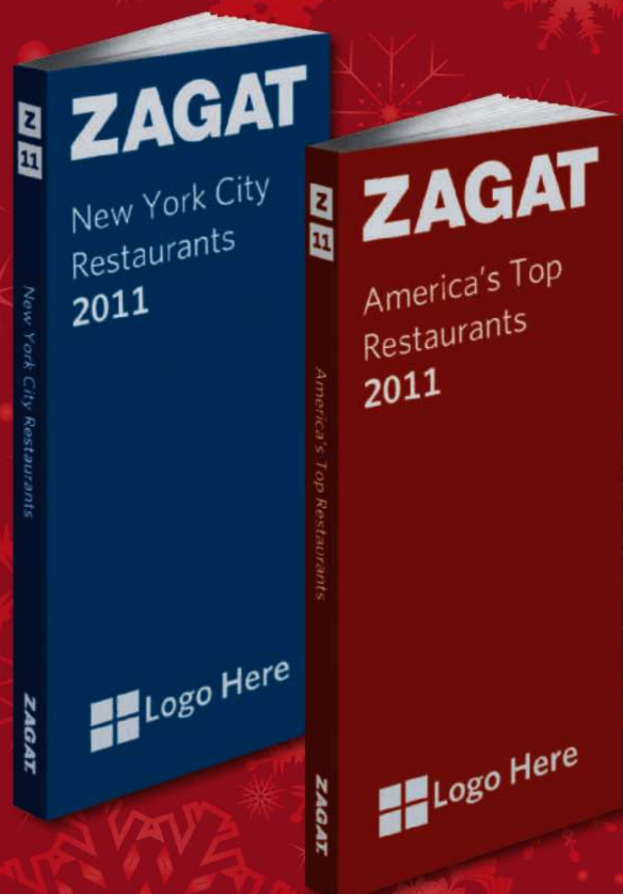


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Confessions of the last man to run Steve Jobs

BEING STEVE'S BOSS



Jobs and Sculley in New York City, 1984

Steve Jobs was 28 years old in 1983, and already recognized as one of the most innovative thinkers in Silicon Valley. The Apple board, though, was not ready to anoint him chief executive officer and picked Pepsi-Cola CEO John Sculley, famous for creating the Pepsi Challenge, to lead the company. Sculley helped increase Apple's sales from $800 million to $8 billion annually during his decade as CEO, but he also presided over Jobs' departure, which sent Apple into what Sculley calls its "near-death experience." In his first extensive interview on the subject, Sculley tells Cultofmac.com editor Leander Kahney how his partnership with Jobs came to be, how design ruled—and still rules—everything at Apple, and why he never should have been CEO in the first place.

You talk about the "Steve Jobs methodology." What is Steve's methodology?
Steve, from the moment I met him, always loved beautiful products, especially hardware. He came to my house and he was fascinated because I had special hinges and locks designed for doors. I had studied as an industrial designer, and the thing that connected Steve and me was industrial design. It wasn't computing.

Steve had this perspective that always started with the user's experience; and that industrial design was an incredibly important part of that user impression. And he recruited me to Apple because he believed that the computer was eventually going to become a consumer product. That was an outrageous idea back in the early 1980s. He felt that the computer was going to change the world and it was going to become what he called "the bicycle for the mind."

What makes Steve's methodology different from everyone

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else's is that he always believed the most important decisions you make are not the things you do, but the things that you decide not to do. He's a minimalist. I remember going into Steve's house and he had almost no furniture in it. He just had a picture of Einstein, whom he admired greatly, and he had a Tiffany lamp and a chair and a bed. He just didn't believe in having lots of things around, but he was incredibly careful in what he selected.

Everything at Apple can be best understood through the lens of designing. Whether it's designing the look and feel of the user experience, or the industrial design, or the system design and even things like how the boards were laid out. The boards had to be beautiful in Steve's eyes when you looked at them, even though when he created the Macintosh he made it impossible for a consumer to get in the box because he didn't want people tampering with anything.

That went all the way through to the systems when he built the Macintosh factory. It was supposed to be the first automated factory, but it really was a final assembly and test factory with a pick-to-pack robotic automation.It is not as novel today as it was 25 years ago, but I can remember when the CEO of General Motors along with Ross Perot came out just to look at the Macintosh factory. All we were doing was final assembly and test, but it was done so beautifully. It was as well thought through in design as a factory as the products were.

Now if you leap forward and look at the products that Steve builds today, today the technology is far more capable of doing things, it can be miniaturized, it is commoditized, it is inexpensive. And Apple no longer builds any products. When I was there, people used to call Apple "a vertically integrated advertising agency," which was not a compliment.

Actually today, that's what everybody is. That's what [Hewlett-Packard] is; that's what Apple is; and that's what most companies are because they outsource to EMS–electronics manufacturing services.

Isn't Nike a good analogy?

Yeah, probably, Nike is closer. The one that Steve admired was Sony. We used to go visit Akio Morita, and he had really the same kind of high-end standards that Steve did and respect for beautiful products. I remember Akio Morita gave Steve and me each one of the first Sony Walkmans. None of us had ever seen anything like that before because there had never been a product like that. This is 25 years ago and Steve was fascinated by it. The first thing he did with his was take it apart, and he looked at every single part. How the fit and finish was done, how it was built.

He was fascinated by the Sony factories. We went through them. They would have different people in different colored uniforms. Some would have red uniforms, some green, some blue, depending on what their functions were. It was all carefully thought out and the factories were spotless. Those things made a huge impression on him.

The Mac factory was exactly like that. They didn't have colored uniforms, but it was every bit as elegant as the early Sony factories that we saw. Steve's point of reference was Sony at the time. He really wanted to be Sony. He didn't want to be IBM. He didn't want to be Microsoft. He wanted to be Sony.

The Japanese always started with the market share of components first. So one would dominate, let's say, sensors, and someone else would dominate memory, and someone else hard drive and things of that sort. They would then build up their market strengths with components and then they would work toward the final product. That was fine with analog electronics, where you are trying to focus on cost reduction–and whoever controlled the key component costs was at an advantage. It didn't work at all for digital electronics, because you're starting at the wrong end of the value chain. You are not starting with the components. You are starting with the user experience.

And you can see today the tremendous problem Sony has had for at least the last 15 years as the digital consumer-electronics industry has emerged. They have been totally stovepiped in their organization. Sony should have had the iPod, but they didn't–it was Apple. The iPod is a perfect example of Steve's methodology of starting with the user and looking at the entire end-to-end system.

On the competition

I REMEMBER AKIO MORITA GAVE STEVE AND ME EACH ONE OF THE FIRST SONY WALKMANS ... THE FIRST THING HE DID WITH HIS WAS TAKE IT APART AND LOOK AT EVERY PART

I want to ask about Jobs' heroes. You say Edwin Land was one of his heroes?

Yeah, I remember when Steve and I went to meet Dr. Land. Dr. Land had been kicked out of Polaroid. He had his own lab on the Charles River in Cambridge. It was a fascinating afternoon, because we were sitting in this big conference room with an empty table. Dr. Land and Steve were both looking at the center of the table the whole time they were talking. Dr. Land was saying: "I could see what the Polaroid camera should be. It was just as real to me as if it was sitting in front of me before I had ever built one."

And Steve said, "Yeah, that's exactly the way I saw the Macintosh." He said, "If I asked someone who had only used a personal calculator what a Macintosh should be like, they couldn't have told me. There was no way to do consumer research on it, so I had to go and create it and then show it to people and say now what do you think?"

Both of them had this ability to not invent products but discover products. Both of them said these products have always existed–it's just that no one has ever seen them before. We were the ones who discovered them.

HE FELT THAT THE COMPUTER WAS GOING TO CHANGE THE WORLD AND IT WAS GOING TO BECOME WHAT HE CALLED "THE BICYCLE OF THE MIND"

On personal computing

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On design

STEVE'S BRILLIANCE IS HIS ABILITY TO SEE SOMETHING AND THEN UNDERSTAND IT AND THEN FIGURE OUT HOW TO PUT IT IN THE CONTEXT OF HIS DESIGN METHODOLOGY— EVERYTHING IS DESIGN

The Polaroid camera always existed and the Macintosh always existed–it's a matter of discovery. Steve had huge admiration for Dr. Land. He was fascinated by that trip.

Ross Perot came and visited Apple several times and visited the Macintosh factory. Ross was a systems thinker. He created EDS [Electronic Data Systems] and was an entrepreneur. He believed in big ideas, change-the-world ideas. He was another one.

Akio Morita was clearly one of his great heroes. He was an entrepreneur who built Sony and did it with great products–Steve is a products person.

You say in your book that first and foremost you wanted to make Apple a "product marketing company."
Steve and I spent months getting to know each other before I joined Apple. He had no exposure to marketing other than what he picked up on his own. This is sort of typical of Steve. When he knows something is going to be important, he tries to absorb as much as he possibly can.

One of the things that fascinated him: I described to him that there's not much difference between a Pepsi and a Coke, but we were outsold 9 to 1. Our job was to convince people that Pepsi was a big enough decision that they ought to pay attention to it, and eventually switch. We decided that we had to treat Pepsi like a necktie. In that era people cared what necktie they wore. The necktie said: "Here's how I want you to see me." So we have to make Pepsi like a nice necktie. When you are holding a Pepsi in your hand, it says, "Here's how I want you to see me."

We did some research and we discovered that when people were going to serve soft drinks to a friend in their home, if they had Coca-Cola in the fridge, they would go out to the kitchen, open the fridge, take out the Coke bottle, bring it out, put it on the table and pour a glass in front of their guests. If it was a Pepsi, they would go out into the kitchen, take it out of the fridge, open it, and pour it in a glass in the kitchen, and only bring the glass out. The point was people were embarrassed to have someone know that they were serving Pepsi. Maybe they would think it was Coke because Coke had a better perception. It was a better necktie. Steve was fascinated by that.

We talked a lot about how perception leads reality and how if you are going to create a reality you have to be able to create the perception. We did it with something called the Pepsi Generation. I had learned through a lecture that Dr. Margaret Mead had given that the most important fact for marketers was going to be the emergence of an affluent middle class–what we call the baby boomers, who are now turning 60. They were the first people to have discretionary income. They could go out and spend money for things other than what they had to have. When we created [the] Pepsi Generation it was created with them in mind. It was always focusing on the user of the drink, never the drink.

Coke always focused on the drink. We focused on the person using it. We showed people riding dirt bikes, water-skiing, or kite flying, hang gliding–doing different things. And at the end of it there would always be a Pepsi as a reward. This all happened when color television was first coming in. We were the first company to do lifestyle marketing. The first and the longest-running lifestyle campaign was–and still is–Pepsi.

We did it just as color television was coming in and when large-screen TVs were coming in, like 19-inch screens. We didn't go to people who made TV commercials because they were making commercials for little tiny black-and-white screens. We went out to Hollywood and got the best movie directors and said we want you to make 60-second movies for us. They were lifestyle movies. The whole thing was to create the perception that Pepsi was No. 1 because you couldn't be No. 1 unless you thought like No. 1. You had to appear like No. 1.

Steve loved those ideas. A lot of the stuff we were doing and our marketing was focused on when we bring the Mac to market. It has to be done at such a high level of perception of expectation that he will sort of tease people to want to find out what the product is capable of. The product couldn't do very much in the beginning. Almost all of the technology was used for the user experience. In fact, we did get a backlash where people said it's a toy. It doesn't do anything. But eventually it did as the technology got more powerful.

On Jobs in exile

I'M ACTUALLY CONVINCED THAT IF STEVE HADN'T COME BACK WHEN HE DID—IF THEY HAD WAITED ANOTHER SIX MONTHS— APPLE WOULD HAVE BEEN HISTORY

Apple is famous for the same kind of lifestyle advertising now. It shows people living an enviable lifestyle, courtesy of Apple's products. Hip young people grooving to iPods.

I don't take any credit for it. Steve's brilliance is his ability to see something and then understand it and then figure out how to put into the context of his design methodology–everything is design.

An anecdotal story: A friend of mine was at meetings at Apple and Microsoft on the same day. And this was in the last year, so this was recently. He went into the Apple meeting (he's a vendor for Apple) and as soon as the designers walked in the room, everyone stopped talking because the designers are the most respected people in the organization. Everyone knows the designers speak for Steve because they have direct reporting to him. It is only at Apple where design reports directly to the CEO.

Later in the day he was at Microsoft. When he went into the Microsoft meeting, everybody was talking and then the meeting starts and no designers ever walk into the room. All the technical people are sitting there trying to add their ideas of what ought to be in the design. That's a recipe for disaster.

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EVERYONE AROUND HIM KNOWS HE BEATS TO A DIFFERENT DRUMMER. HE SETS STANDARDS THAT ARE ENTIRELY DIFFERENT THAN ANY OTHER CEO WOULD SET

Everyone around him knows he beats to a different drummer. He sets standards that are entirely different than any other CEO would set.

He's a minimalist and constantly reducing things to their simplest level. It's not simplistic. It's simplified. Steve is a systems designer. He simplifies complexity.

If you are someone who doesn't care about it, you end up with simplistic results. It's amazing to me how many companies make that mistake. Take the Microsoft Zune. I remember going to [the Consumer Electronics Show] when Microsoft launched Zune and it was literally so boring that people didn't even go over to look at it ... The Zunes were just dead. It was like someone had just put aging vegetables into a supermarket. Nobody wanted to go near it. I'm sure they were very bright people, but it's just built from a different philosophy. The legendary statement about Microsoft, which is mostly true, is that they get it right the third time. Microsoft's philosophy is to get it out there and fix it later. Steve would never do that. He doesn't get anything out there until it is perfected.

That drives some people a little bit crazy. Did it drive you crazy?
It's O.K. to be driven a little crazy by someone who is so consistently right. Looking back, it was a big mistake that I was ever hired as CEO. I was not the first choice that Steve wanted to be the CEO. He was the first choice, but the board wasn't prepared to make him CEO when he was 25, 26 years old. They exhausted all of the obvious high-tech candidates to be CEO. ... Ultimately, David Rockefeller, who was a shareholder in Apple, said let's try a different industry and let's go to the top headhunter in the United States who isn't in high tech: Gerry Roche.

They went and recruited me. I came in not knowing anything about computers. The idea was that Steve and I were going to work as partners. He would be the technical person and I would be the marketing person.

The reason why I said it was a mistake to have hired me as CEO was Steve always wanted to be CEO. It would have been much more honest if the board had said, "Let's figure out a way for him to be CEO. You could focus on the stuff that you bring and he focuses on the stuff he brings."

Remember, he was the chairman of the board, the largest shareholder, and he ran the Macintosh division, so he was above me and below me. It was a little bit of a façade, and my guess is that we never would have had the breakup if the board had done a better job of thinking through not just how do we get a CEO to come and join the company that Steve will approve of, but how do we make sure that we create a situation where this thing is going to be successful over time?

I made two really dumb mistakes that I really regret because I think they would have made a difference to Apple. One was when we were at the end of the life of the Motorola processor ... we took two of our best technologists and put them on a team to go look and recommend what we ought to do.

They came back and they said it doesn't make any difference which RISC architecture you pick, just pick the one that you think you can get the best business deal with. But don't use CISC. CISC is complex instruction set. RISC is reduced instruction set.

So Intel lobbied heavily to get us to stay with them ... [but] we went with IBM and Motorola with the PowerPC. And that was a terrible decision in hindsight. If we could have worked with Intel, we would have gotten onto a more commoditized component platform for Apple, which would have made a huge difference for Apple during the 1990s. So we totally missed the boat. Intel would spend $11 billion and evolve the Intel processor to do graphics ... and it was a terrible technical decision. I wasn't technically qualified, unfortunately, so I went along with the recommendation.

The other, even bigger failure on my part was if I had thought about it better, I should have gone back to Steve.

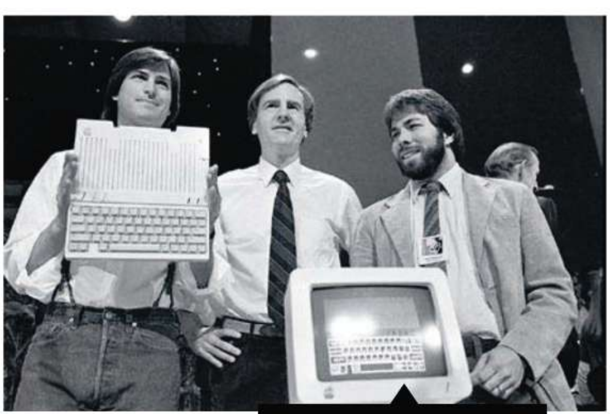
I wanted to leave Apple. At the end of 10 years, I didn't want to stay any longer. I wanted to go back to the East Coast. I told the board I wanted to leave, and IBM was trying to recruit me at the time. They asked me to stay. I stayed and then they later fired me. I really didn't want to be there any longer.

The board decided that we ought to sell Apple. So I was given the assignment to go off and try to sell Apple in 1993. So I went off and tried to sell it to AT&T, to IBM, and other people. We couldn't get anyone who wanted to buy it. They thought it was just too high risk because Microsoft and Intel were doing well then. But if I had any sense, I would have said, "Why don't we go back to the guy who created the whole thing and understands it? Why don't we go back and hire Steve to come back and run the company?"

It's so obvious, looking back now, that that would have been the right thing to do. We didn't do it, so I blame myself for that one. It would have saved Apple this near-death experience they had.

I'm actually convinced that if Steve hadn't come back when he did–if they had waited another six months–Apple would have been history. It would have been gone, absolutely gone.

People say he killed the Newton—your pet project—out of revenge. Do you think he did it for revenge?
Probably. He won't talk to me, so I don't know. Ⓑ



SAL VEDER/AP PHOTO

Jobs, Sculley, and Apple co-founder Steve Wozniak unveil the Apple IIc in 1984

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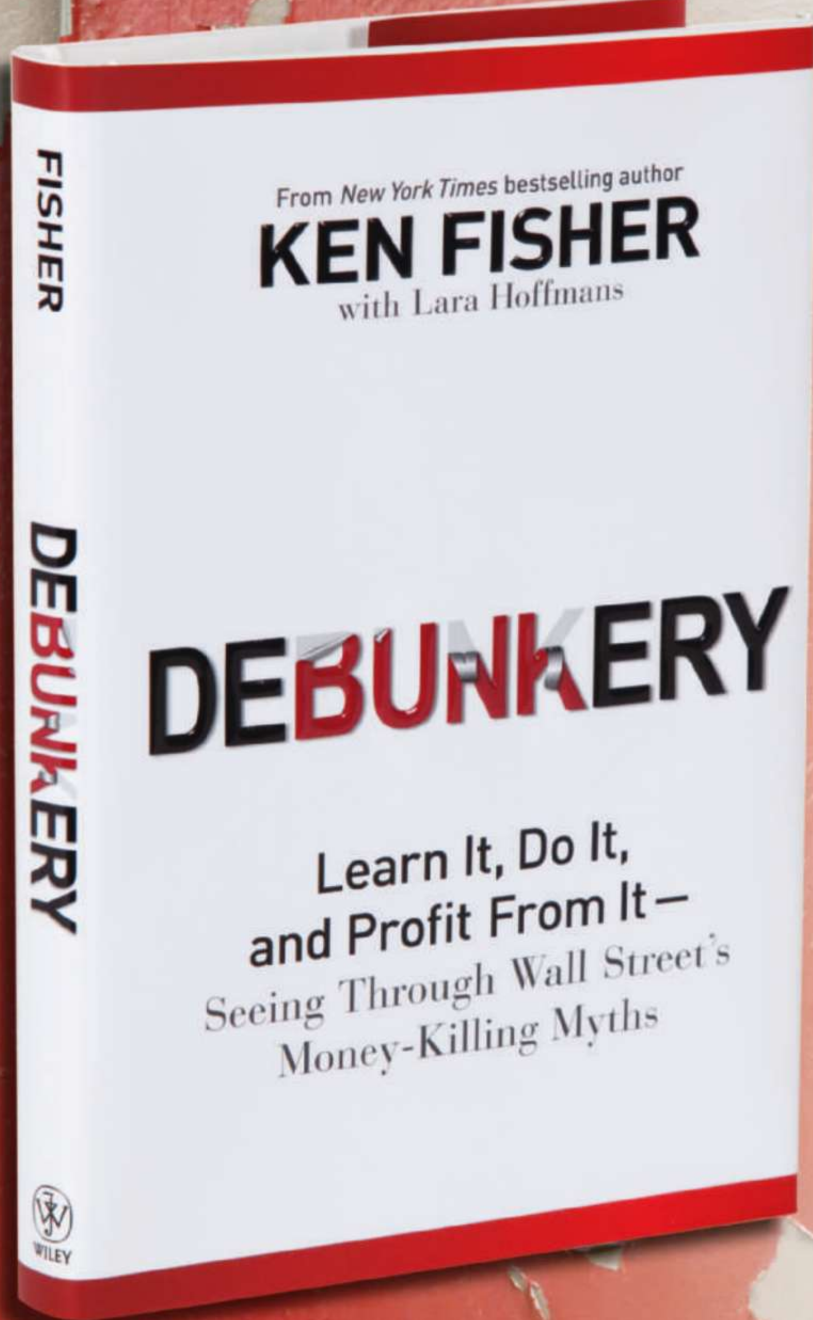
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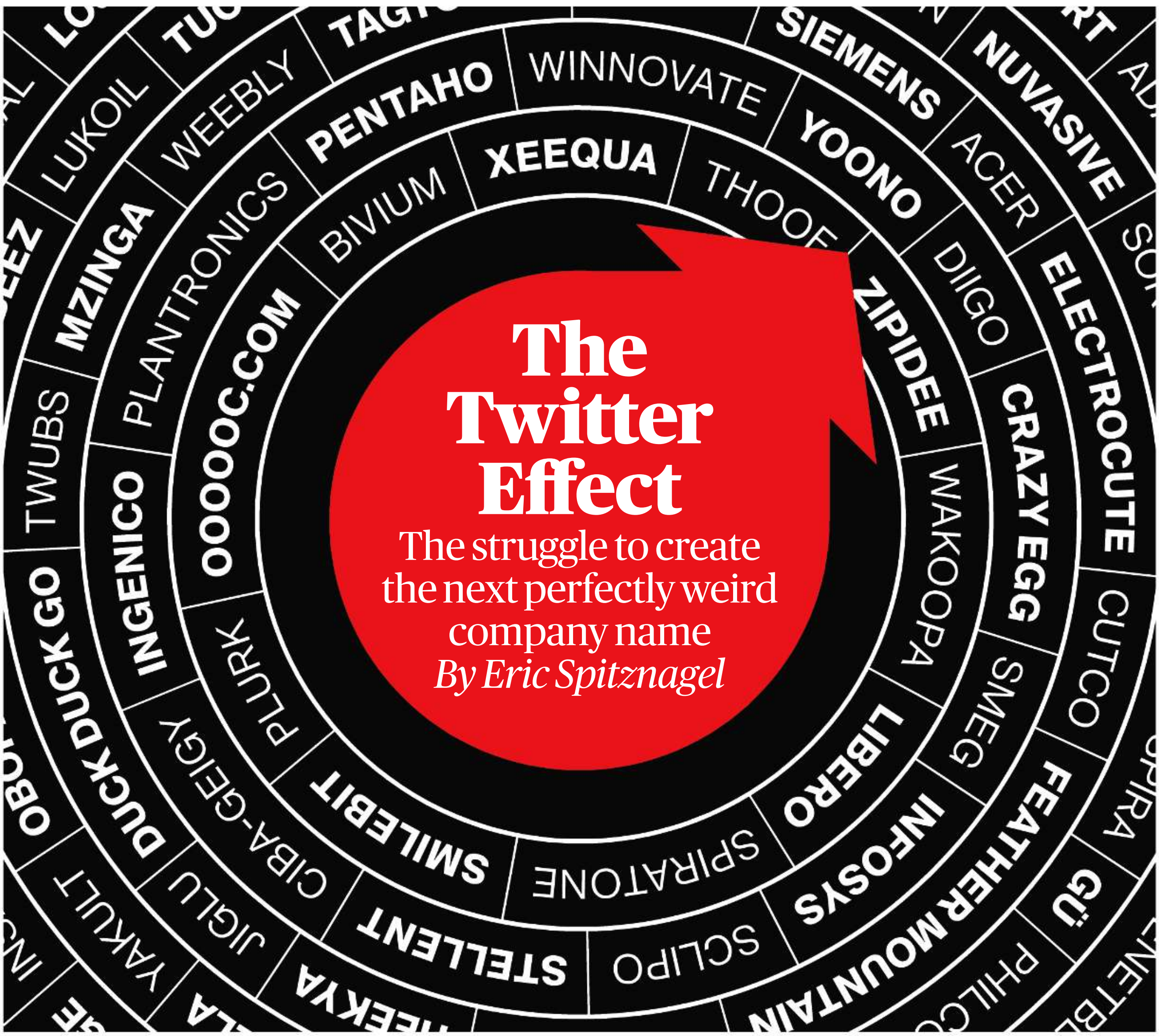
How you wait for your mocha latte is revealing
Page 106

Starbucks & Reality TV & Music & Basketball

Etc.



Not every former AAU star has had the success of Brandon Jennings
Page 113



The Twitter Effect

The struggle to create the next perfectly weird company name

By Eric Spitznagel

Real, actual company names

TOP: SCOTT CUNNINGHAM/NBAE VIA GETTY IMAGES

Etc. The Corporate Name Game

What's in a name? If it happens to be Twitter, the answer is roughly $1.1 billion. In just four years, Twitter has gone from birdsong to the most used word in the English language, according to Global Language Monitor data for 2009. ("Obama" was a close second.) Twitter spokesman Matt Graves explains that his company's insipidly brilliant name was "the result of a brainstorm between a small group of employees at Odeo, the San Francisco podcasting startup where Twitter initially began as a side project. They came up with possible names, including 'Jitter' and 'Twitter,' and put them in a hat," Graves says. Twitter won.

Now the race is on to coin the next weirdly memorable company name. The challenge is that coming up with something as powerful as Verizon or Häagen-Dazs (made-up words that have entered the cultural lexicon), let alone Google (the founders' own misspelling of the numerical term "googol"), has become even harder. There are more than a million names, slogans, and logos registered at the U.S. Patent and Trademark Office. And according to VeriSign, a global domain name registry company, 11 million Internet domain names have been registered in the last 12 months alone, a 6 percent increase from the year before. In all, 193 million Internet domain names are now unavailable to new businesses.

"The days of accidental naming are over," says Naseem Javed, the founder of ABC Namebank, a New York-based consultant specializing in corporate nomenclature. To stand out in the overcrowded global marketplace, he says, a company's name must now be especially odd. "Ten, twenty years ago you could start a business and take the name in any direction," he says. "Now, with 200 countries on the cyber-platform around the globe, finding the right name has become an expert's field."

More companies than ever are seeking professional advice about their identities. Although client numbers are hard to come by, there are some 50 naming firms worldwide, the majority of them launched within the last decade, according to DMOZ, the Open Directory Project, the Internet's largest yellow pages. "It's just like modern art," says Phillip Davis, president and owner of Tungsten Branding, a business-naming firm in Brevard, N.C. "I study words. I live inside words. What could they become, what could they be shaped into, are they malleable?" He takes his profession very seriously. "In our industry, we call [words] a partially shaped vessel."

One of the most popular recent naming trends, according to Javed, is the Google-derived double-O. "A lot of companies feel that the double-O gives them some kind of comfort level," he says. "You have names like Joost, Boost, Wakoopa, iSkoot, and Qool." According to Javed, there is a guiding principle in the double-O strategy. "Basically, you put the double-O in the center, and then you drop one letter on the left and one letter on the right," he says. "Hopefully it gives you some magic." By ABC's estimate, there are approximately 760 double-o company names around the world.

The true art of corporate naming is to be weird—but not too weird. Jay Jurisich, creative director at San Francisco-based naming and branding agency Igor, points to the array of companies that seem to have been assigned a random combination of letters: Xignux, Epizon, Spansion, Assurant, Primaxis, Qorus. "While every snowflake is technically unique," Jurisch says, "in a blizzard they all blend together and become indistinguishable."

A weird name with an idea behind it, however, can stand out: take hairyLemon, for instance, a Web development company in Christchurch, New Zealand. Graham Dockrill, hairyLemon's co-founder, explains that the name comes from cockney slang for "here at eleven"—as in 11 a.m., when pubs typically open in New Zealand. "So you would say 'hairy lemon' and I would know to meet you for a pint when the pub opens," he says. Technically, drinking in the morning has nothing to do with the company itself, but it has attracted potential clients. Dockrill estimates that at least a third of hairyLemon's business comes from the name. "People might be looking at three or four different

"With 200 countries on the cyber-platform... finding the right name has become an expert's field"

Enter the Lexicon

Susan Purcell, a London-based linguist, and Jay Jurisich, of San Francisco branding agency Igor, explain what makes these big names work.



What makes BlackBerry such a catchy name? Purcell says it's all in the letters. "The B sounds relaxed," she says. The Y is friendly, she notes, reminiscent of names Buddy and Betty. In between are a series of short vowels, which, Purcell claims, are "crisp like the clicking of buttons."

The snack Nabisco once bragged was "America's Favorite Cookie" has a name that's become part of the culture. The real brilliance of the word Oreo, says Jurisich, is its symmetry. "The bookending O's nicely mirror the physical shape and structure of the cookie itself," he explains.

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VIAGRA

The strength of this product name, says Purcell, is in the first two letters. Vigor, vitality, virile, and victory are all things that Viagra indirectly promises to deliver. She also points out that Viagra "rhymes with Niagara," which is especially useful if waterfalls turn you on.



WII

The product is pronounced "we," which, Purcell attests, is a clear expression of group participation. "The ii's could be two players or two remotes," she says. In other words, Nintendo is subliminally telling its customers that playing video games isn't just for social outcasts anymore.



GOOGLE

The original name for this popular search engine company was supposed to be "Googol" (a scientific term for 1 followed by one hundred zeros), but the founders made a typo while trying to register it as a domain name. The error, says Jurisich, is pure poetry. "It's warm and human," he says.

companies," he says, "and they'll pick us because we've got such a quirky name."

Like those who named Twitter and Google, the people behind hairyLemon simply had the touch. Not every do-it-yourself namer is so successful. In June 2009, Russian gas company Gazprom announced a joint venture with Nigeria's NNPC, which gave rise to an offshoot company they called "NiGaz." However, the amalgamation of "Nigeria" and "Gazprom" struck many Americans as better suited to an N.W.A. album than a Russian gas monopoly. Perfecting a name in the Digital Age, according to Tungsten's Davis, is both art and science. His most famous invention is PODS, short for Portable On-Demand Storage. The moving and storage company's original name was Portables, but Davis thought it "sounded too much like a toilet." A name like PODS, he says, creates a feeling of "what, tell me more" instead of "huh, I don't get it."

The biggest mistake among amateur name creators, Davis believes, is overanalyzing the language. Amateurs can become too focused on the linguistics and the number of vowels and consonants. "They're so grammatically focused that they miss the bigger picture," he says. "They forget that there's got to be a story connected to it. Other people get the story, but the word is so clunky that nobody cares about the story. They'll be like, 'In Latin, this word means the god of business.' Well, yeah, but it's got 16 syllables and five x's and three z's."

"It's just like modern art," says a naming professional. "I live inside words"

For those without the capital to employ a professional, the Internet is now littered with free business-name generators. Not all are legitimate; some are actually mocking you. In 2003 a London advertising agency called The Design Conspiracy launched a website called whatbrandareyou.com in which visitors could type in their "core values" (like "dynamic" or "passionate") and company goals (like "global leadership" or "client focus") and the site would concoct a personalized brand name. "We were poking fun at a number of ridiculous rebrands at the time, like Accenture and Consignia," says Ben Terrett, a former Design Conspiracy member. He says all 150 of the site's "generated" names were carefully devised to be as insipid as possible. Still, the trick was so convincing that 20 of their fake names—including Bivium, Libero, and Winnovate—were registered as trademarks by real companies.

The business of creating marketable names won't be getting less competitive or confusing anytime soon. As London-based linguist Susan Purcell points out, "There are around 600,000 entries in the Oxford English Dictionary, many fewer words than there are businesses." So the next time you need a new corporate name, don't expect to find it in the OED. And don't expect to throw a few vowels and consonants in a blender and come up with a winner. The best approach, in fact, may be to trust serendipity. Or hairy lemon. Ⓑ

VIAGRA: NATHAN GRIFFITH/CORBIS; WII: NINTENDO/PR NEWSWIRE/NEWSCOM

Coffee Kinesiology

As you wait for your venti soy misto, think about the image you're projecting

By Tim Murphy

In another effort to boost quality, Starbucks confirmed earlier this month that its baristas would soon be preparing fewer drinks simultaneously. The news sent shock and fear throughout white-collar culture—longer lines are coming to a world in which queuing up at Starbucks is already a daily ritual.

Waiting for coffee isn't merely a hassle: It's a revealing pastime. "When we go in a Starbucks, we're in charge," says Patti Wood, author of *Success Signals: A Guide to Reading Body Language*. "Our $5.50 makes us kings and queens of our destiny." As a result, Starbucks lines often showcase postures of excitement, Wood says. A coffee break is also a "transition from one focal point of professionalism to another," says Tonya Reiman, author of *The Power of Body Language*.

Just how professional? About 2 percent of the more than 11,000 Starbucks stores are in Manhattan—and one proved a perfect laboratory for *Bloomberg Businessweek* to study hundreds of people on a weekday. What follows is a taxonomy of the 10 most common Starbucks waiting-line stances, as analyzed by a panel of behavioral experts: Wood; Reiman; Marilyn Puder-York, author of *The Office Survival Guide*; Don Norman, author of *Living with Complexity*; and Dario Maestripieri, author of the forthcoming *The Biology of Everyday Life*. Next time, don't forget the tip jar. We're watching you. Ⓑ

38% *(of people observed)*

The Awkward BlackBerryer

BlackBerry junkies feel "awkwardness or emptiness when they're not digitally connected," says Wood. They send business e-mails when it would be better to take a break and "do their deep breathing," says Puder-York.

5%

The Muzak Swayer

Some queue-huggers unconsciously rock to Starbucks' adult contemporary playlists featuring artists like Sarah McLachlan. "It goes back to how we were swayed in the womb," says Wood. Maestripieri notes: "Some people don't get fat because they're constantly moving."



9%

The Refiller

In addition to clutching empty cups, cheapskates seeking refills often bob their heads and tap their feet. "That reminds me of, 'Please sir, I want some more'" from *Oliver Twist*," says Wood. "These people are charged up, and if others don't mirror their speed, they'll be agitated."

3%

The Primper

Some female line-waiters toss their hair and check their makeup. They also tend to wear the highest heels. "They're showing their wares and saying, 'Appreciate the fact that I am a young, attractive female,'" says Wood. "It's a very feminine thing to do," says Maestripieri.

Other Noticeable, Yet Less Common Starbucks Line Behavior Traits ▸ FACE SELF-MASSAGERS / Wood:
are, exposing many of your private actions and thoughts." ▸ CASHIER FOOT-POINTERS / Wood: "Where your feet point, your

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7%

The Food-Case Fondler

Touching the snack case with your hands or body? It's disgusting but forgivable because physical contact with food is reassuring, suggests Norman. The guy with his leg on the display like a dog on a hydrant? Not O.K. He may be thinking, Wood says, "'I'm the king.'"

6%

The Klutzy Wallet Fumbler

Some men nervously mishandle their back pockets during wallet extraction. "They feel like they're exposing themselves," says Wood. Reiman explains that tactile pressure like rubbing can be a comforting gesture "that helps you through the moment."

5%

The Arm Toucher

These people come in pairs, apparently from the same office, and chat while lightly touching each other's arms. "It shows their connection and says, 'I reward you for being with me,'" Wood notes. Adds Reiman: "It's a way of saying, 'I'm confident in our relationship.'"



8%

The Sandwich Cradler

Gently nestling plastic-wrapped sandwiches and cups of yogurt next to the female bosom is a "gender-based comforting cue," says Woods. According to Reiman, the female line-waiter might be "feeling slightly nervous, apprehensive, or insecure."

14%

The Food-Case Starer

Some people glance longingly at Double Fudge Mini-Donuts—but then get only coffee. "There's some fantasizing going on," says Reiman. Norman has a different scientific theory: "They simply blanked out."

3%

The Counter Seducer

Certain customers chat up the staff beyond usual pleasantries. It slows the initial interaction, says Wood, "but often ends up creating a better experience." Maestripieri notes: "Research shows that people who actually enjoy engaging in social interactions do better in life and live longer."

ILLUSTRATION BY BEN KIRCHNER

It's reminiscent of "monkeys in stress mode." ▶ WILD GESTICULATOR / **Norman: "You've lost track mentally of where you heart follows."** ▶ TOUCH-THE-FOOD-THEN-PUT-IT-DOWNERS / **Maestripieri: "That's weird. I don't know what that means."**



Pawn shop proprietors and cable TV stars: Corey, Rick, and Richard Harrison

The Pawn of Civilization

Pawn Stars, the top cable reality show, may be the most revealing series of our age. *By Andy Fixmer*

Over-tanned teenagers with poufy hair, White House party crashers, forgotten members of *The Brady Bunch*, washed-up '80s rockers: These are the gods of the reality television pantheon. Now Peter Brady and Bret Michaels must make room for three unlikely newcomers: Rick Harrison, his father Richard, and son Corey. The proprietors of Gold & Silver Pawn Shop are the leading men of the History Channel's *Pawn Stars*, which happens to be cable's top-rated unscripted show. Yes, *Pawn Stars* outdraws *Jersey Shore*–and it's making the somnolent History Channel, a network previously known for Hitler documentaries and *Ice Road Truckers*, one of cable's hottest networks.

Conveniently located less than two miles from the Strip, the 24-hour Gold & Silver has become an unlikely fixture on the Vegas tourist scene. Buses pull up first thing every morning and disgorge hundreds of people hoping to watch others trade their junk for cash. Before the History Channel began airing the show, in July 2009, the shop averaged between 70 and 100 customers per day. That number has now grown to more than 1,000. As a result, the Harrisons have hired nearly 30 new employees and are expanding their showroom by two-thirds, to 15,000 square feet. They've even installed misting machines to cool waiting customers. If this strikes you as surprising, you're not alone. "We hoped the show would help business," Rick Harrison says. "We thought we'd get a season or two. Now we're talking about Season 4. It's kind of amazing!"

> **"We thought we'd get a season or two," says Harrison. "Now we're talking about Season 4. It's kind of amazing!"**

It shouldn't be so surprising. Reality television mimics the culture more closely than many would like to admit. When the housing bubble was in full swing, Americans fixated on shows about buying, decorating, and flipping houses for quick profit. The interest even led to a show about an NFL wide receiver-turned-decorator–though *Keyshawn Johnson: Tackling Design* wasn't renewed. Bravo built a lucrative franchise around high-living housewives, and MTV brought us the travails of spoiled young adults from Laguna Beach to Hollywood to Manhattan.

ALL IMAGES: COURTESY OF HISTORY CHANNEL/PAWN STARS

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The Harrisons are hawking this mid-19th century Ormolu French clock for $6,500



As Americans now cope with mortgages that exceed the value of their homes, it's natural that a show about people hawking their effects for fast cash has taken off. *Pawn Stars*, which resumed its third season last week, takes audiences to the heart of the recession—Las Vegas, the American city hardest hit by foreclosures and unemployment. "This is about people deleveraging and trying to get out of debt," says David Halle, a popular culture professor at the University of California at Los Angeles. "It's a little more relevant now than shows about how to become a real estate millionaire."

It doesn't hurt that the Harrisons look like extras from *The Sopranos* and bicker like Marge Simpson's sisters. They also happen to be very good at their day jobs. Rick Harrison has a knack for wresting prized possessions—Civil War muskets, 200-year-old Scottish daggers, and Mickey Mouse rotary phones—from his customers at cut-rate prices. In a recent episode, a woman tried to sell a U.S. flag taken to the moon aboard NASA's Apollo 16 mission. A flag from an earlier moon landing, the audience discovers, fetched $23,900 just months before. After some haggling, however, the woman settles for $4,000. Despite the discount, everyone seems content. "I'm very happy with what I settled for," the woman says into the camera. "I can head to Paris, France."

Not every transaction works so seamlessly. In the show's July 2009 pilot, the owner of a woodworking shop tried to pawn a 3,000-pound table saw. The device, retailing for $20,000, was to be the collateral for a $7,000 loan. When Harrison was unable to turn the device on, the woodworker was forced to settle for $4,500. "I need the money; times are slow right now," he said plaintively. However, desperate moments are often left off-camera. "It's embarrassing when you need quick cash," Rick Harrison explains. "Most customers who are in that situation don't want to be on television."

Like many reality programs, *Pawn Stars* was born out of curiosity. Brent Montgomery and Colby Gaines, principals of Leftfield Pictures, were in Las Vegas for Gaines' bachelor party weekend in 2008 when they were struck by the city's array of eclectic and somewhat seedy pawn shops. Assuming these shops were filled with unique characters, they searched for a family-run business to build a show around. They soon found the Harrisons and filmed a pitch tape.

Their timing was perfect. Just more than a year earlier, Nancy Dubuc had left A&E to become president of the History Channel with a mission to counterweigh the network's battle anniversary tributes with more confectionary original content. Dubuc picked up *Pawn Stars* but fine-tuned its story line to adhere to the network's brand. On-camera experts consult on the sales of historical items, such as pawned Kennedy papers, corporate iconography, and high-end NASA tchotchkes.

"It's embarrassing when you need quick cash," says Harrison of the customers who visit his shop

Though Dubuc didn't discourage the renegade antics that have made reality TV so popular. In a recent episode, Rick Harrison sends an employee on an impossible mission: Get Bob Dylan to autograph a copy of the album *Self Portrait* before a gig at Caesars Palace. The employee stalks the casino's grounds until he spots Dylan walking to his tour bus, where he accosts him.

"How did you find me here?" asks Dylan. "I heard you were doing a show and I just figured I would walk around until I found you," says Chumlee, the employee. The reclusive star chuckles, then scrawls "To Chumlee, Bob Dylan" across the record sleeve. The item isn't for sale.

It's unclear what a strengthening U.S. economy will do to *Pawn Stars*, but knockoffs are already hitting the small screen. The appallingly titled *Hardcore Pawn* recently debuted on truTV, and it's possible a copy-cat version of the show may be coming to network television, according to Mike Darnell, who oversees reality programming at Fox. "We're big fans," says Darnell. "We believe there's a network play for that type of show." If Keyshawn Johnson has proven anything, there is. **B**

This bronze medal from the 1996 Olympics is on sale for $8,000



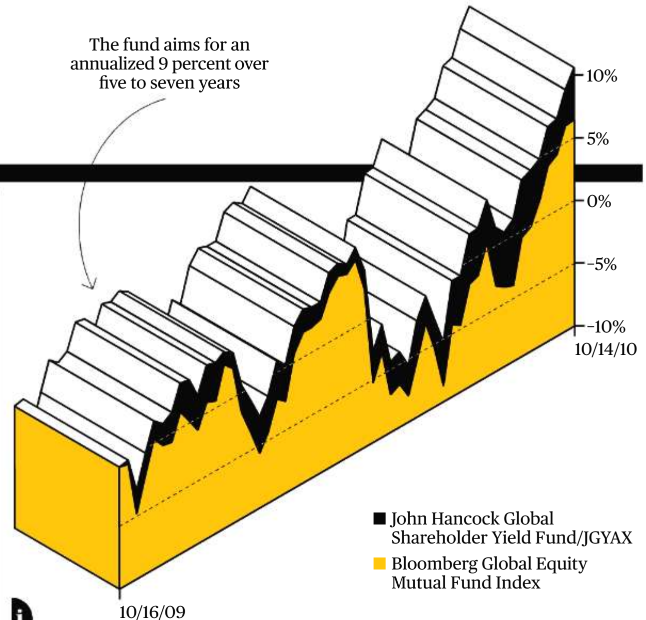
Once considered a state-of-the-art console, this stylish piece of furniture is priced at $700





Gold & Silver will let you take this 1969 Rokon Trail Breaker bike home for $5,500

A Capital Strategy For Shareholders



Epoch Investment Partners' William Priest hunts for companies deploying cash in shareholder-friendly ways

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THE STATS DATA: BLOOMBERG

Priest founded Epoch Investment Partners, which manages $12.8 billion. In the U.S., Epoch uses a "shareholder yield" strategy in funds such as the Mainstay Epoch Global Equity Yield Fund and the Hancock fund above.

Priest on his plays



1. McDonald's

McDonald's is in a challenging industry. Even so, comparable sales grew 3.8 percent in 2009 and the number of customers rose 1.4 percent. Cash flow from operations totaled $5.8 billion last year, and about $2 billion went back into the business—mostly to open new restaurants but also to redo 1,850 locations. McDonald's repurchased $2.9 billion of its shares in 2009 and returned some of its free cash flow to shareholders through $2.2 billion in dividends. It yields 3.2 percent.



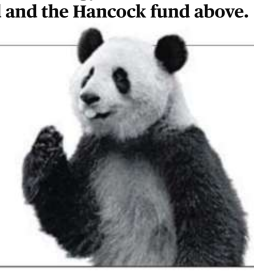
2. Johnson & Johnson

More than 70 percent of J&J's revenues come from No. 1 or No. 2 market share products like Tylenol and Purell. Profits rose last year on operating efficiencies and a continued reduction in costs. This led to $16.6 billion in cash from operating activities. Of that cash, $2.4 billion went to capital spending, $2.5 billion to acquisitions, $1.2 billion to share buybacks, and $5.3 billion in dividends. Since 2006, J&J has paid more than $15 billion in dividends and repurchased $10.5 billion in stock.



3. Vodafone

Vodafone has 7 percent of the global market and is in 31 markets in mobile communications. Expansion in markets like Turkey and India, as well as more use of data services, fueled an 8.4 percent rise in revenues in 2009 and free cash flow that exceeded $11 billion. One cost reduction program was met ahead of schedule and a new one is under way. After investing in network capability and service enhancements, management hiked the annual dividend by 7 percent. The stock now yields 5 percent.



4. China Mobile

They're the No. 1 telecommunications company in China, with more than 550 million subscribers. It's one of the strongest consumer brands, which lets it command premium pricing. China Mobile has a sizable cash position—24 percent of its $214 billion market capitalization—and generates substantial free cash flow. The company has a 3.2 percent dividend yield and has said it may return cash to shareholders beyond the dividend. It's positioned to take advantage of mobile search and mobile payments.

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The New Wall of Sound

The SoundLink streams your playlists wirelessly—for a hefty price. *By Rich Jaroslovsky*

Mentioning the name Bose is an easy way to start a fight among audiophiles. Do its Wave radios, speaker systems, and headphones really provide high-end sound? Or does the company merely benefit from clever marketing, winning premium prices for ordinary (or worse) performance?

Computer users can now join the fray, thanks to SoundLink, Bose's solution for streaming music wirelessly within your home. Bosehounds will cheer for a single box that's simple, portable, and makes Cee Lo—if not necessarily Beethoven—sound great. Skeptics will bemoan its lack of flexibility and expandability. And, at $550, the price. Definitely the price.

The SoundLink system consists of a speaker and a small transmitter—Bose calls it a "key"—with a folding antenna that plugs into a computer's USB port. There's no software to install, nor do you even need a home Wi-Fi network; the transmitter and speaker create an independent connection. Bose estimates the transmitter's range at 60 feet: I did better than that, even with a floor in between. As added benefits, the SoundLink has an auxiliary port allowing you to directly connect an MP3 or CD player. (Remember those?) And although Bose's documentation says little about it, the SoundLink can stream music from some Bluetooth-enabled wireless devices.

SoundLink comes with a wall-wart power adapter, but its internal lithium-ion battery can play for three hours unplugged with the volume cranked up; play it more softly and you're likely to do considerably better. The 4½-lb. device's portability is critical because of one glaring weakness: You can't network the SoundLink to run multiple units in different rooms. It's one computer, one speaker only.

The unit comes with a tiny, minimalist remote for skipping tracks, adjusting the volume, and the like. Unfortunately, it's just too limited. If you have a Wi-Fi network, use iTunes, and have an iPod Touch, iPhone, or iPad, you'll get much more control by using Apple's free Remote app.

The SoundLink provides remarkably rich sound for such a compact (12 in. wide by 6.7 in. high by 5.1 in. deep) unit. Is it worth $550? You may find yourself pulled into another argument. But that's part of what makes it a Bose. Ⓑ

The 4½-lb. device delivers rich sound, wirelessly

SoundLink's battery lasts for 3 hours with the volume cranked up



Its controller is limited: Instead, use your iPhone's Remote app

The transmitter's range exceeds 60 feet and can even penetrate a floor of your house.

BOTTOM: PHOTOGRAPH BY PLAMEN PETKOV FOR BLOOMBERG BUSINESSWEEK

SPEAKERS OF THE HOUSE

Less expensive options for streaming your home music library



EOS Converge ($200-$250)
The economical wireless speaker is simple and portable.



Sonos ZonePlayer S5 ($399)
Create a multiroom music network, with something different on each ZonePlayer.



Sony Altus Multi-Room Music System for PC ($300)
Expandable with a vast array of add-ons and alternative configurations.



Logitech Squeezebox Radio ($200)
Compact tabletop unit makes it almost as easy to tune into Internet radio as the broadcast kind.

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Youth basketball impresario Joe Keller's next generation of stars hard at work



Million Dollar Babies

The seedy business of youth basketball—and the middle-aged moguls who run it. *By Will Leitch*

Jaylin Fleming's cross-over dribble has scouts drooling. Videos of his training sessions have become YouTube sensations, and his bedroom is adorned with posters of himself. Despite the hype, Fleming has said, he stays humble by reading the Bible each day. He may also be praying for a growth spurt. At 5 feet 2 inches, he's an inch shorter than the smallest player ever to wear an NBA uniform. Here's the good news: He's only 10 years old, and puberty beckons.

In the meantime, Fleming is ranked as the nation's top sixth-grade basketball prospect by Middle School Elite, a website about junior high players that has an avid following among grown men. This isn't a joke: Trying to spot the next Kobe or LeBron before he's hit the ninth grade has become a multimillion-dollar business. At its center is Joe Keller, chief executive officer of Adidas Phenom, a high-profile basketball camp for middle- and high school boys hoping to play in the NBA.

In June 2001, *Sports Illustrated* reporter George Dohrmann discovered Keller, then a small-time youth coach, as he was desperately trying to carve out a niche for himself on the Amateur Athletic Union (AAU) basketball scene, where ambitious young athletes play for privately financed traveling teams. The two men came to an agreement: Keller would grant Dohrmann total access to his then-fledgling program, the "Inland Stars," while Dohrmann would confer on Keller the legitimacy of having a *Sports Illustrated* reporter tailing him to tournaments across the country. Over the ensuing decade, Dohrmann documented Keller's unlikely ascent from parks department employee and part-time coach to millionaire youth basketball impresario. In often horrifying detail, *Play Their Hearts Out* shows how this self-promotional empire was built on the jumpshots of young boys.

The AAU circuit is big-time basketball's own dirty sausage factory. The teams are funded by sneaker companies that forge early relationships with impressionable young players, who benefit from the exposure to college coaches and pro scouts. In the end, though, the true beneficiaries are the adults who start the teams and insert themselves into the middle of this ugly, ruthless world of marketing youngsters. Southern California AAU coach



i

Play Their Hearts Out: A Coach, His Star Recruit, and the Youth Basketball Machine

By George Dohrmann,
432 pp, BALLANTINE, $26.00

TOP: JOE KELLER

Pat Barrett, for example, once received $250,000 for convincing a player–current Timberwolves star Kevin Love–to sign with a particular sports agent. How could Barrett exert such an influence? Easy: He'd known Love since the player was in the fifth grade.

According to Dohrmann, Keller's main contribution to this world was making it more exploitative, and extending its tentacles deeper into childhood. Where AAU programs have traditionally focused on junior high and high school players, Keller went even younger. In a sports culture obsessed with youth, this was a brilliant business plan, and it made him a rich man. Team Cal, his traveling team of fifth-grade "prodigies," was built on the 10-year-old shoulders of Demetrius Walker. Walker, as Keller told Dohrmann in 2000 with a conspicuous lack of irony, was "the best 10-year-old in the country. NBA first-round for sure." Readers hope that Keller is clairvoyant. At the time, Dohrmann writes, Walker's mother was barely keeping the family's lights on as his father served a jail sentence for three felony convictions. Yet, readers learn, middle-school basketball prognosticators don't have to be clairvoyant. In essence, they're just promoters, and this is where Keller separates himself from other coaching entrepreneurs. His ability to publicize preadolescents to shoe companies–while positioning himself as their exclusive handler–allowed him to earn the attention of Adidas, buy a McMansion with a backyard waterfall, and become a full-time youth basketball mogul.

How did Keller develop his strategy? He stole it from the playbooks of his forebears. In the mid-'80s, a Nike executive named Sonny Vaccaro understood the profit in signing graduating college players to sneaker endorsements. Vaccaro took his business one step further, in 1984, by founding a youth all-star basketball camp that collected the nation's top talent in the presence of adoring coaches and sneaker executives. The camp led to the rise of others and the birth of a new industry with its own class of shady tycoons. Once the Internet came along, coaches and agents were able to watch developing players in real time and follow their stats throughout the year. Former Indiana University journalism student Clark Francis capitalized on the frenzy by turning his newsletter into The Hoop Scoop Online, which ranks players from grade school to high school. Vaccaro, who left a job with Reebok in 2007, has since renounced the world he created as "a broken system." It's been anything but that for him, though: James Gandolfini has signed on to play him in an HBO movie.

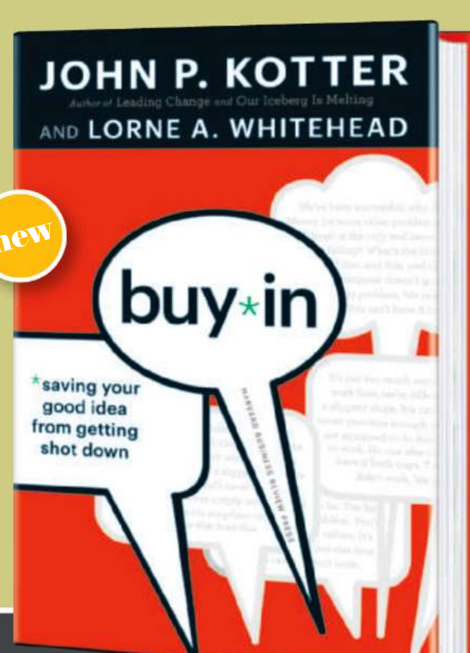
Like an equities trader, Keller knows when to sell a bad investment. Unfortunately for many of his former protégés, that's what he does. As Walker develops into solid but

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unspectacular player in high school—and begins dropping precipitously on the prospect rating boards—Keller no longer has time for him. When Walker calls Keller for advice, the coach confides that he's been spreading bad information about Walker to motivate him. After a dumbfounded Walker subsequently e-mails Keller for an explanation, Keller drops the player.

Walker: You bought a house and Violet [Keller's wife] a car and you got wood floors all through your house and a big pool and what do I have?

Keller: It's a shame we can't continue our relationship. I guess we have to go our separate ways.

Walker: I don't want that.

Keller: I wish we could solve all our issues but I guess we will have to go our separate ways.

Dohrmann remains focused on the kids abused by this scouting process, and he picks up their stories long after Keller has moved on from their lives. (A comparison to H.G. Bissinger's classic look at Texas high school football, *Friday Night Lights,* is fair; one suspects that Dohrmann, like Bissinger, will stay in many of their lives long after his book is in paperback.) It's clear where Dohrmann's sympathies lie, certainly to Keller, who has announced plans to sue the author and his publisher.

Dick Vitale won't be calling Demetrius Walker's name this March. After leaving Arizona State University for the University of New Mexico, he's been forced to sit out the season due to NCAA transfer rules. Despite Keller's prediction, it's a near certainty that Walker will never get drafted or play in the NBA. Few in the world of amateur basketball will remember his name, and even fewer will care. There are too many other things to worry about in the amateur hoops business. Every year ushers in a new 10-year-old phenomenon, whether its Demetrius Walker or Jaylin Fleming, that middle-aged men depend on for their McMansions and backyard waterfalls. B

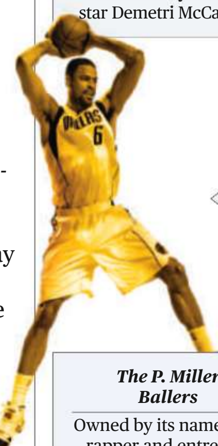
The Kids Are All Right

The Amateur Athletic Union offers young players the best exposure to pro and college coaches. Here are the most renowned teams and recent top alums.

The Illinois Wolves

Last season's National Basketball Association No. 2 overall draft pick, **Evan Turner**, once played for the Wolves—considered the top Chicago-area team—alongside University of Illinois star Demetri McCamey.





The Southern California All-Stars

The L.A.-based team is coached by Pat Barrett (former University of Nevada-Las Vegas coach Jerry Tarkanian once called him "the biggest whore I've ever met"), who launched **Tyson Chandler**'s career.

The P. Miller Ballers

Owned by its namesake, rapper and entrepreneur Master P, the Houston-based club counts Milwaukee Bucks guard **Brandon Jennings** and Toronto Raptors shooting guard DeMar Derozan as alums.





The Miami Tropics

Florida's top AAU team, largely underwritten by Nike, is best known for producing Memphis Grizzlies point guard **O.J. Mayo**, who as a college player received cash gifts that violated NCAA rules.

FROM TOP: FERNANDO MEDINA/NBAE VIA GETTY IMAGES; GLENN JAMES/NBAE VIA GETTY IMAGES; SCOTT CUNNINGHAM/NBAE VIA GETTY IMAGES; D.CLARKE EVANS/NBAE VIA GETTY IMAGES

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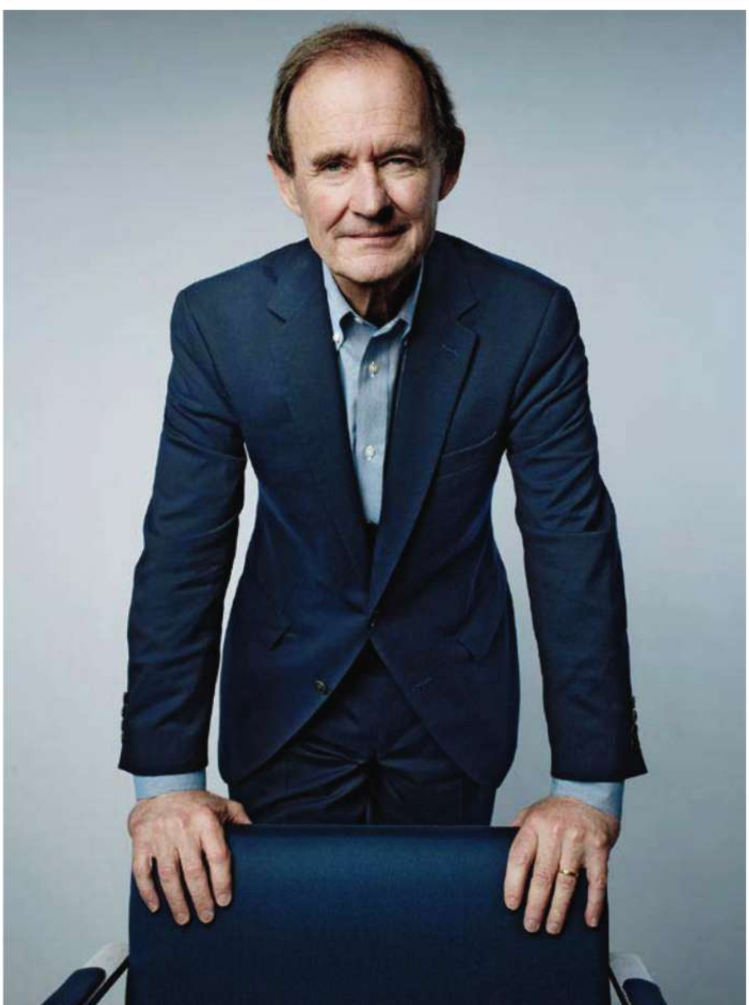
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"I didn't want the firm to lose its most important client, but I didn't want to abandon Steinbrenner. ... By the following Tuesday, I resigned"

The star litigator on picking between his clients and his firm, and striking out as an entrepreneur—at age 56



I was representing the New York Yankees against Major League Baseball [in a dispute over sponsorship rights] in May 1997 when Time Warner—then the largest client of my law firm, Cravath, Swaine & Moore—acquired Turner Broadcasting. Turner owned the Atlanta Braves, and they didn't want their law firm representing the Yankees.

I had been at Cravath my entire career. At 56 I had a multimillion-dollar-per-year income, total job security, and the best lawyers in the country on my cases. I didn't want the firm to lose its most important client, but I didn't want to abandon Steinbrenner. The issue was raised by Time Warner on a Friday. By the following Tuesday, I resigned. It was the only way I could be loyal to my firm and my client.

A few days after I left, there was an article about it in *The New York Times*. That morning, [real estate executive] Sheldon Solow, who had been a client at Cravath, called me and said, "Now you have two clients." By the end of the day, I had Georgia-Pacific and DuPont, too. The first call I made was to a brilliant lawyer named Bob Silver. Bob brought over an associate. My son Jonathan was graduating from law school, and I convinced him to come, too. By Thanksgiving, we knew this was going to be successful.

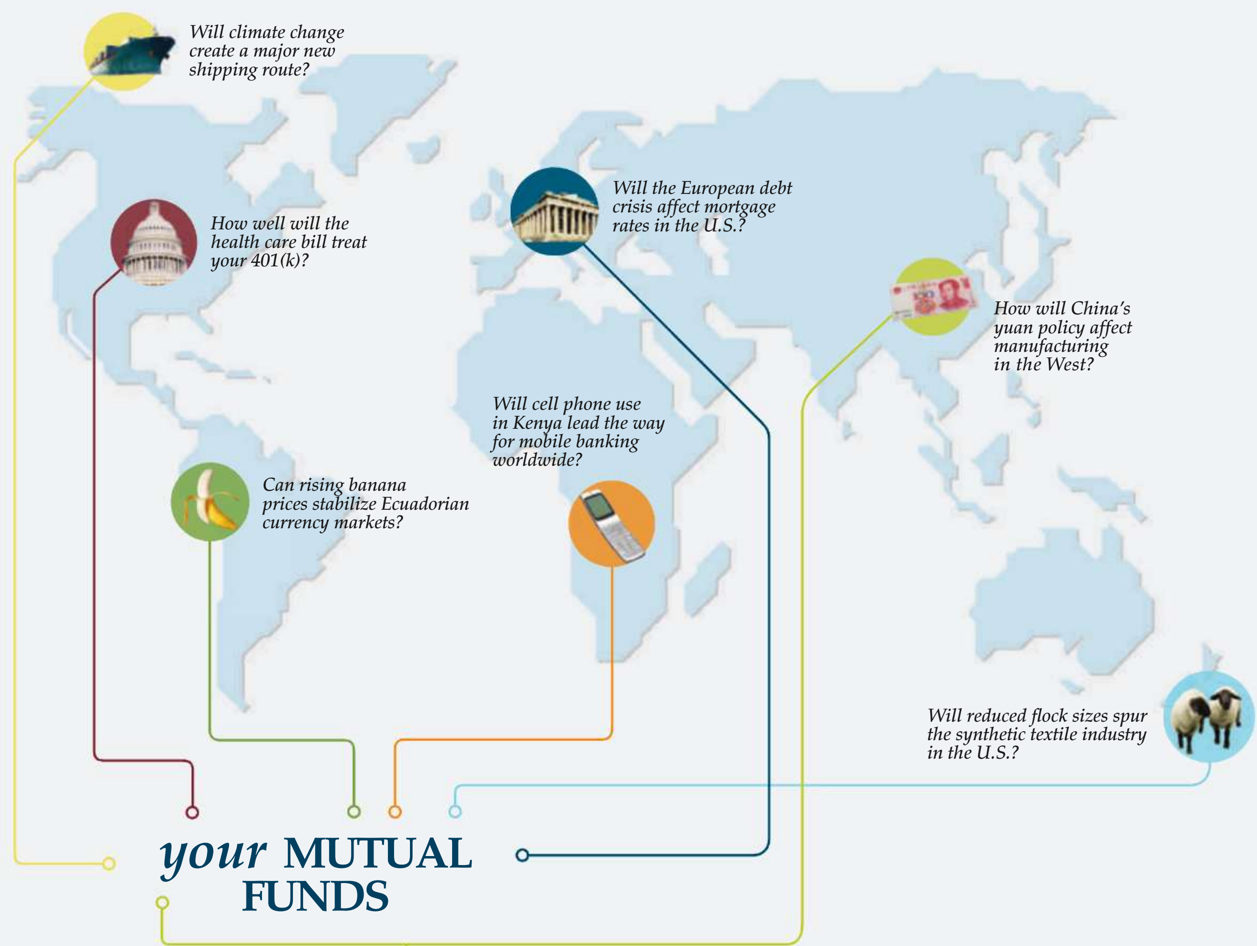
One thing that could have screwed it up would have been not spending enough time on client relationships. The hardest decisions are knowing what to take on. Most clients expect some participation from me, and I'm careful in choosing what to do. There are a few factors: my availability, the nature and importance of the case, the significance of the client to the firm, and chemistry. If I'm going to spend a lot of time with them, they have to be people I want to work with.

Law firms either grow or decline. You must recruit the very, very best people. They won't come unless they can see a path to their own professional development. I would have been happy to see us settle at 150 lawyers. We have more than 240 lawyers now, and the firm still has to grow. It's a necessary evil to attract the best people. B —*As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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